

No. 11134

2417

United States
Circuit Court of Appeals

For the Ninth Circuit.

R. E. SPAULDING, L. B. MANLOVE and P. M.
MANLOVE, co-partners doing business under
the firm name and style of Manlove & Spauld-
ing Mfg. Co.,

Appellants,

vs.

DOUGLAS AIRCRAFT COMPANY, INC., a
corporation, and UNITED STATES OF
AMERICA,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Southern District of California,
Central Division

FILED

1945

PAUL P. O'BRIEN,
CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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RONALD WALKER and

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Assistants U. S. Attorney

600 U. S. Post Office & Court House Bldg.

Los Angeles 12, Calif. [1*]

District Court of the United States for the Southern District of California Central Division

Civil Action No. 3806-BH

R. E. SPAULDING, L. B. MANLOVE and P. M. MANLOVE, co-partners doing business under the firm name and style of Manlove & Spaulding Mfg. Co.,

Plaintiffs,

vs.

DOUGLAS AIRCRAFT COMPANY, INC., a corporation,

Defendant.

COMPLAINT FOR DECLARATORY JUDGMENT AND MONEY JUDGMENT

Plaintiffs complain of defendants and for cause of action allege:

I.

That at all times herein mentioned R. E. Spaulding, L. B. Manlove and P. M. Manlove were and are now co-partners doing business under the firm [2] name and style of Manlove & Spaulding Mfg. Co.; that at all times herein mentioned each of said plaintiffs was and now is a citizen of the State of California, and a resident and inhabitant of the County of Los Angeles, State of California, within the Central Division of the District Court of the United States for the Southern District of California; that at all times herein mentioned the business of said plaintiff was and now is being operated

and conducted in said City of Los Angeles, State of California.

II.

That at all times herein mentioned defendant above named was and now is a corporation organized and existing under and by virtue of the laws of the State of Delaware; that at all times herein mentioned said defendant corporation was and now is doing business in the State of California, and within the Central Division of the United States District Court for the Southern District of California.

III.

That the value of the rights which plaintiffs in this suit seek to protect and the value of the property and property rights and the extent of injury involved herein exceed the sum of \$3000.00, exclusive of costs and interest, and are, to-wit: the sum of \$31,048.33.

IV.

That from the 1st day of March, 1944, to and including the 31st day of July, 1944, at said City of Los Angeles, State of California, and within the jurisdiction of the above entitled court, defendant corporation became indebted to plaintiff in the sum of \$31,048.33 for goods, wares and merchandise manufactured and made by plaintiff and sold and delivered to defendant corporation at the special instance, order and request of defendant corporation and at the agreed price of \$31,048.33; that no part of said sum of \$31,048.33 has been paid by defendant corporation to plaintiffs and defend-

ant corporation refuses to pay said sum or any part thereof to plaintiffs solely for the reasons hereinafter set forth.

V.

That an actual controversy exists between plaintiffs and defendant corporation relating to the rights and legal relations of the parties to this action and pertaining to the payment by defendant corporation to plaintiffs of said sum of \$31,048.33; that the facts and circumstances giving rise to and constituting such controversy are as follows, to-wit:

(a) That at all times herein mentioned Henry L. Stimson was and now is the duly appointed, qualified and acting Secretary of War of the United States; that at all times herein mentioned the said Henry L. Stimson has assumed and pretended and does now assume and pretend to be charged, as said Secretary of War, with the duty of administering section 403 of the [3] Sixth Supplemental National Defense Appropriation Act of 1942 (56 Stat. 245), approved April 28, 1942, as amended by section 801 of the Revenue Act of 1942 (56 Stat. 982), approved October 21, 1942, as further amended by section 1 of the Military Appropriation Act of 1944 (57 Stat. 348) and as further amended by the Act of July 14, 1943 (57 Stat. 564, 565) and the Revenue Act of 1943, said statutes and amendments thereto being hereafter referred to as the "Renegotiation Act".

(b) That at all times herein mentioned Robert P. Patterson was and now is the duly appointed, qualified and acting Under Secretary of War of

the United States; that at all times herein mentioned said Robert P. Patterson has assumed and pretended and does now assume and pretend to be charged with the duty of administering said Renegotiation Act, as said Under Secretary of War, by virtue of the direction of the said Secretary of War; that with respect to the matters herein complained of said Robert P. Patterson, as said Under Secretary of War, has at all times purported to act by virtue of authority delegated to him by defendant Henry L. Stimson, as said Secretary of War, and has assumed to act for and represent the said Secretary of War, the Secretary of the Navy of the United States, the Secretary of the Treasury of the United States, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective boards of directors of the Defense Plant Corporation, Metal Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company, under the provisions of said Renegotiation Act.

(c) That at all times mentioned herein plaintiffs were and are now engaged in the manufacture, production and sale of mechanical fittings and parts and of airplane parts, all of which are manufactured and produced in the City of Los Angeles, County of Los Angeles, State of California, and are sold by plaintiffs to various persons, firms and corporations throughout the United States ordering said parts and materials from the plaintiffs; that all of the business done by plaintiffs in the manu-

facturing, production and sale of said parts and articles during the fiscal year ending December 31, 1942, was with private firms, corporations and individuals and not with the United States of America; that all of said business constitutes the basis on which the order of February 2, 1944, as hereinafter set forth, was made and entered.

(d) That on February 2, 1944, the defendant Robert P. Patterson purporting to act as said Under Secretary of War, and purporting to act by virtue of the authority delegated to him by the defendant Henry L. Stimson, as Secretary of War, and purporting to act under said Renegotiation Act did make a unilateral order and determination purporting to determine excess profits made by plaintiffs during said fiscal year ending December 31, 1942, which said order was and is in the words and figures following, to wit: [4]

“War Department
Office of the Under Secretary
Washington

“DETERMINATION OF EXCESSIVE
PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended.

“Whereas, Manlove and Spaulding Manufacturing Company, a partnership (hereinafter referred to as the Contractor), holds contracts and subcon-

tracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

“Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its fiscal year ended 31 December 1942, under said contracts and subcontracts; and

“Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

“Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

“Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the

Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

“That \$110,000 of the profits realized by the Contractor during its fiscal year ended 31 December 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

“That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any [5] amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

“That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

“That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take

any and all action which may be necessary or desirable to effect such elimination.

2 February 1944

ROBERT P. PATTERSON

Under Secretary of War"

(e) That on May 1, 1944, the said Robert P. Patterson, purporting to act as said Under-Secretary of War, and pretending and purporting to act under and by virtue of the provisions of said Renegotiation Act, did make an order, directed to defendant corporation above named and did cause said order to be served on said defendant corporation, which said order was and is in the words and figures following, to wit:

“War Department
Office of the Under Secretary
Washington, D. C.

1 May 1944

SPRAR

Douglas Aircraft Company
3000 Ocean Park Boulevard
Santa Monica, California

Re: Direction to withhold from Manlove
& Spaulding Manufacturing Company
of Los Angeles, California, pursuant
to the Renegotiation Act.

Gentlemen:

Pursuant to the authority vested in the Secretary of War under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942,

as amended and duly delegated to me, I found and determined on 2 February 1944 that certain of the prices and profits realized by Manlove & Spaulding Manufacturing Company during its fiscal year ended 31 December 1942 under contracts and sub-contracts subject to renegotiation, were excessive.

In accordance with the authority and duty to eliminate said excessive profits, I hereby direct you to withhold for the account of the [6] United States any and all amounts (not in excess of \$110,000 in the aggregate) otherwise due or which shall become due from you to said Manlove and Spaulding Manufacturing Company.

This direction shall be effective immediately and shall continue in effect until further notice from me.

You are also directed to report in writing to the Chairman of the War Department Price Adjustment Board, Room 3D 573, the Pentagon, Washington, D. C., any amounts which you may, from time to time, withhold for the account of the United States pursuant hereto.

Very truly yours,

(s) ROBERT P. PATTERSON

Under Secretary of War"

(f) That said orders of February 2, 1944, and of May 1, 1944, are and each of them is void; that neither said Secretary of War nor said Under Secretary of War had the power or authority to make said orders and are without power or authority to enforce said orders according to their

terms or otherwise or at all for the reason that said Renegotiation Act is void, without lawful effect and repugnant to the Constitution of the United States in each of the following particulars, to wit:

(1) Said Renegotiation Act is repugnant to Article I, section 1, and Article II, section 8, paragraph 18 of the Constitution of the United States in that it unlawfully delegates legislative power to the defendants and to the secretaries of the various departments as in said Act set forth;

(2) That said Renegotiation Act is repugnant to the Fifth Amendment to the Constitution of the United States in that it deprives plaintiffs of their property without due process of law;

(3) That said Renegotiation Act is repugnant to the Fifth Amendment to the Constitution of the United States in that it takes plaintiffs' property for public use without just or any compensation;

(4) That said Renegotiation Act is repugnant to the Tenth Amendment to the Constitution of the United States in that it attempts to exercise a power not delegated to the United States;

(5) That said Renegotiation Act is repugnant to Article I, section 1, and Article I, section 8, paragraph 18, of the Constitution of the United States and to the Fifth and Tenth Amendments thereto, in that by said Act it is provided that "whenever, in the opinion of the secretary of a department (including the Secretary of War) the profits realized or likely to be realized from any contract with said department or from any subcontract thereunder, whether or not made by the

contractor, may be excessive, the Secretary is authorized and directed to require the contractor or subcontractor to renegotiate the contract price", and that upon said renegotiation "the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract" and neither said Renegotiation Act nor any other provision [7] of law sets forth or declares any rules, standard, guide or policy by which said Secretary is to be guided in the administration of said Act or in the determination of what are or are not excessive profits other than the arbitrary order, whim or caprice of said Secretary; that by said Act Congress has attempted to delegate to the Secretary the power to refix contract prices and has directed, authorized and empowered him, by unguided opinion and without setting forth any standard, gauge or rule, to determine what profits are excessive;

(6) That said Renegotiation Act further violates said foregoing provisions of the Constitution and the Fifth and Tenth Amendments thereto in that it purports to vest in the Secretary the power to renegotiate contracts made and entered into between private persons, firms and corporations and to which contracts the government of the United States is not a party, and in instances where no privity of contract exists between the contractor or subcontractor and the United States;

(7) That said Renegotiation Act is further repugnant to said Articles of the Constitution of the United States and to said Fifth and Tenth Amend-

ments thereto, in that it provides that upon any negotiation conducted and made and upon any order entered pursuant thereto by the Secretary, said Secretary may make a revision of said contracts renegotiated by reducing the contract price of said contract, but said Renegotiation Act contains no provision whereby the contractor can have his contract price raised in the event that such contract price did not produce a fair profit on the business done under said contract or any profit at all;

(8) That said Renegotiation Act is further repugnant to said Articles of the Constitution and to said Fifth and Tenth Amendments thereto in that it does not provide for any equality of treatment as to all persons, firms or corporations whose contracts are made subject to the provisions of said Act, in the following particulars, to wit:

(a) That by the provisions of said Act the Secretary is authorized, in his discretion, to exempt from some or all of the provisions of said Act "any contracts or subcontracts under which, in the opinion of the Secretary, the profits can be determined with reasonable certainty when the contract price is established * * * when the period of performance under said contract or subcontract will not be in excess of thirty days";

(b) That by the provisions of said Act the Secretary may exempt from the provisions of said Act a portion of any contract or subcontract during a specified period or periods if in the opinion of

the Secretary. the provisions of the contract are otherwise adequate to prevent excessive profits;

(c) That by the provisions of said Act the Secretary is authorized to exempt contracts and subcontracts, both individually and by general classes and types, from the operation of said Act;

(d) That said Renegotiation Act is made to apply only to contracts [8] involving amounts in excess of \$100,000.00 and does not apply to contracts involving amounts less than \$100,000.00;

(9) That said Renegotiation Act is further violative of said Articles of the Constitution and Amendments in that it directs the Secretary in determining excess profits under any contract not to make allowances for any salaries, bonuses or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount and not to make allowance for any excess reserves set up by the contractor or for any costs incurred by the contractor which are excessive and unreasonable; that said Act does not contain any standard, guide or rule for the determination of what are reasonable salaries, bonuses or compensation or for the determination of what are or are not excessive or unreasonable costs or reserves;

(10) That said Renegotiation Act further violates said Articles of the Constitution and Amendments thereto in that it authorized the Secretary, without any rule or standard to guide his discretion, to exempt from renegotiation contracts or portions of contracts made or to be performed during a specified period or periods of time, said

period or periods of time to be fixed by the arbitrary action of the Secretary;

(11) That in exercising the purported power to determine excess profits the Renegotiation Act does not contain any limitation upon or description of the character of the material or data which the Secretary may consider;

(12) That said Renegotiation Act is further violative of said Articles of the Constitution and Amendments thereto in that it contains no provisions for giving to the person whose contract is sought to be renegotiated a hearing or notice of place and time of hearing of such renegotiation; that said Renegotiation Act does not contain any provision for the reception of evidence or of giving to the contractor the right to cross-examine witnesses; that said Renegotiation Act does not contain any provision requiring the Secretary to set forth in any manner the facts or figures forming the basis of any decision determining the existence of any excess profits;

(13) That at the time of the making of said order of February 2, 1944, said Renegotiation Act did not contain any provision allowing a review in any court of the United States of any unilateral arbitrary or other decision made by a Secretary determining the existence of excess profits;

(14) That said Renegotiation Act is further repugnant to said Article of the Constitution and Amendments thereto in that it permits each contract sought to be renegotiated by the Secretary under the provisions of said Act to be construed

in a manner different from that of any other contract in the computation of what constitutes an excess profit and permits the use of a different standard or guide in the determination of what constitutes excess profits even when dealing with contracts of exactly the same class, covering the same materials and operating during the same period of time. [9]

(g) That at all times herein mentioned, plaintiffs have made available to the United States and to its branches, agencies and commissions, charged with the administration of said Renegotiation Act, all of their books, papers, records, documents and accounts relative to their business done during the fiscal year ending December 31, 1942, that at all times plaintiffs have denied that the Government or the Secretary of War acting on behalf of the Government, had any right, power or authority to renegotiate any contracts made by plaintiffs with their customers and have never agreed with the Government, or with any Secretary or with any officer or agent of the Government, or with defendant corporation, to the renegotiation of any of its said contracts; that plaintiffs are advised and believe and therefore allege that the profits realized by them during the fiscal year ending December 31, 1942, were and are not excessive.

(h) That defendant corporation maintains and contends that by virtue of the order made by said Under Secretary of War on May 1, 1944, it is without right, power or authority to pay to plaintiffs said sum of \$31,048.33, or any part thereof,

and that under said order it has no alternative save and except to withhold and on demand to pay said sum and the whole thereof to the United States. On the other hand, plaintiffs maintain and contend that, for the reasons hereinabove stated, said order of May 1, 1944, is null and void and of no force or effect, that said Renegotiation Act is in violation of the Constitution of the United States and of the Fifth and Tenth Amendments thereto as hereinabove set forth and that plaintiffs are entitled to the immediate payment of said sum from defendant corporation.

Wherefore, plaintiffs pray for the following relief and judgment, to wit:

1. That this court, pursuant to the provisions of the Federal Declaratory Judgment Act, declare and decree that said Renegotiation Act is unconstitutional, null and void; that the purported order and direction so made by said Under Secretary of War on May 1, 1944, is null and void and was and is beyond the power, authority and jurisdiction of said Under Secretary of War to make, and neither creates nor imposes any duty on defendant corporation to do the things as in said order specified; that the order purporting to determine excess profits so made on February 2, 1944, was and is null and void.

2. That plaintiffs have judgment against defendant corporation for the sum of \$31,048.33, together with interest thereon from the 31st day of July, 1944, and that defendant be directed to pay said sum to plaintiffs and be directed not to with-

hold said sum or any part thereof for the account of the United States or to pay said sum or any part thereof to the United States. [10]

3. For such other and further relief as may be meet and just in the premises.

4. For costs of suit herein expended.

JOS. I. McMULLEN,

LEO R. FRIEDMAN,

Attorneys for Plaintiffs.

State of California,

County of Los Angeles—ss.

R. E. Spaulding, being first duly sworn, deposes and says:

That he is one of the plaintiffs in the above entitled action; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge except as to those matters therein stated upon information and belief and as to such matters he believes it to be true.

R. E. SPAULDING

Subscribed and sworn to before me this 11th day of August, 1944.

[Seal]

MAX C. HODOR

Notary Public in and for the County of Los Angeles,
State of California.

My Commission expires May 28, 1946.

[Endorsed]: Filed Aug. 11, 1944.

[Title of District Court and Cause.]

CERTIFICATE

To the Honorable Francis Biddle, the Attorney General:

The undersigned, Ben Harrison, Judge of the United States District Court for the Southern District of California, pursuant to Title 28, Section 401 of the United States Code, does hereby certify:

I.

That on August 11, 1944 a complaint for declaratory judgment and money judgment in the above entitled action, was filed in the United States District Court for the Southern District of California, Central Division.

II.

Said action draws in question the constitutionality of an Act of Congress affecting the public interest, to-wit: the Sixth Supplemental National Defense Appropriation Act of 1942 (56 Stat. 245), approved April 28, 1942, as amended by section 801 of the Revenue Act of 1942 (56 Stat. 982), approved October 21, 1942, as further amended by section 1 of the Military Appropriation Act of 1944 (57 Stat. 348) and as further amended by the Act of July 14, 1943 (57 Stat. 564, 565) and the Revenue Act of 1943, known as the Renegotiation Act.

III.

As neither the United States nor any agency thereof, nor any officer nor employee thereof, as such officer or employee, is named as a party there-

to, I hereby certify these facts in conformity with the provisions of said Section 401, Title 28, United States Code.

IV.

Authority is hereby granted to the United States to intervene in the above entitled proceeding and become a party thereto for presentation of evidence and argument upon the question of the constitutionality of said Act.

Done in open court this 12 day of September, 1944.

BEN HARRISON

United States District Judge

[Endorsed]: Filed Sept. 12, 1944.

[Title of District Court and Cause.]

ANSWER

Answer of Douglas Aircraft Company, Inc., a corporation, defendant, to the complaint herein:

For answer to the complaint of the plaintiffs in the above-entitled cause, Douglas Aircraft Company, Inc., a corporation, defendant above named says:

First Defense

I.

The complaint fails to state a claim against defendant upon which relief can be granted.

Second Defense

II.

The Court lacks jurisdiction to try in this suit any issue as to which the Tax Court has jurisdiction pursuant to Section 701 of the Revenue Act of 1943 (Public 235, 78th Congress). That section provides *REW:ds

that any contractor aggrieved by a determination of the amount of his excessive profits may file a petition with the Tax Court of the United States for a redetermination thereof. The Tax Court is given "exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency." The proceeding before the Tax Court is a proceeding de novo. Defendant is informed and believes and therefore alleges that plaintiffs have not filed a petition in the Tax Court for redetermination of their excessive profits and that their time for filing such a petition has expired. Plaintiffs cannot, therefore, litigate in this Court any issue which relates to the amount, if any, of plaintiffs' excessive profits.

Third Defense

III.

The plaintiffs are not entitled to the relief sought for the reason that the Renegotiation Act is constitutional and valid and the action taken pursuant thereto was in all respects lawful.

Fourth Defense

IV.

Answering the first paragraph of the complaint, defendant admits the allegations therein contained.

V.

Answering the second paragraph of the complaint, defendant admits the allegations therein contained.

VI.

Answering the third paragraph of the complaint, defendant admits that the value of the property and property rights involved herein exceeds the sum of \$3,000.00, exclusive of costs and interests; but defendant alleges that such value is not more than \$27,580.80.

VII.

Answering the fourth paragraph of the complaint, defendant denies that it became indebted to the plaintiff in the sum of \$31,048.33 in the manner alleged in said paragraph IV, but avers that the amount of the alleged indebtedness is \$27,580.80; and defendant states that it is informed and believes and therefore alleges that by reason of the orders and determinations made by Robert P. Patterson and described in the complaint, said sum of \$27,580.80 is not owing to plaintiffs.

VIII.

Answering the fifth paragraph of the complaint, defendant admits that an actual controversy exists between plaintiffs and defendant relating to the rights and legal relationships of the parties to this

action and pertaining to the payment by defendant to plaintiffs of the amount of the alleged indebtedness; and admits the allegations in paragraph V(a), V(b), V(d) and V(e) contained. With respect to the allegations in paragraph V(c), defendant admits that plaintiffs were and are engaged in the manufacture, production, and sale of mechanical fittings, and of airplane parts, manufactured and produced in the City of Los Angeles, County of Los Angeles, State of California, but defendant denies that all of plaintiffs' business for the fiscal year ending December 31, 1942, was the basis on which the order of February 2, 1944, was made. With respect to the remaining allegations of paragraph V(c), defendant alleges that it is without information or knowledge sufficient to form a belief as to the truth thereof. Defendant denies the allegations contained in paragraph V(f). With respect to the allegations in paragraph V(g), defendant alleges that it is without information or knowledge sufficient to form a belief as to the truth thereof, except that defendant alleges that on or about September 14, 1942, defendant prepared and sent to plaintiffs a letter dated September 14, 1942, a true copy of which is attached hereto as Exhibit A and plaintiffs on November 14, 1942, replied by a letter dated that day, a true copy of which is attached hereto as Exhibit B.

IX.

Defendant denies each and every allegation of the complaint not herein admitted, controverted or specifically denied.

Fifth Defense

X.

Defendant is informed and believes and therefore alleges:

(a) Under the circumstances created by the war, the enactment by Congress of the Renegotiation Act was required to protect the public welfare and to bring the war to a successful and speedy conclusion at a minimum cost to the nation in life and property.

(b) With respect to the matters here in controversy, all action taken by Henry L. Stimson and Robert P. Patterson, and by all persons acting for them or under their direction or on their behalf, was taken pursuant to and was authorized or required by the Renegotiation Act.

Wherefore, defendant denies that plaintiffs are entitled to the relief, or any part thereof, in the said complaint demanded or any relief whatever, and prays to be hence dismissed with its reasonable charges in this behalf sustained.

CHARLES H. CARR ,

United States Attorney

RONALD WALKER

Assistant United States
Attorney

ROBERT E. WRIGHT,

Assistant United States
Attorney

EXHIBIT "A"

(Copy)

Douglas Aircraft Company, Inc.
Santa Monica, California

September 14, 1942

Cable Address "Douglasair"

In reply refer to File G305NM

Mailing Address: Materiel Division, P. O. Box
9337, Station S. Los Angeles, California.

To All Vendors:

Subject: Renegotiation Clause

Gentlemen:

You are probably familiar with Section 403 of the Sixth Supplemental National Defense Appropriation Act (Public Law 528, 77th Congress, approved April 28, 1942). This is the statute prescribing renegotiation for government contracts and subcontracts thereunder.

Section 403 requires us to insert a renegotiation clause in each subcontract involving more than \$100,000, and the provisions of some of our more recent contracts define "subcontract" as including practically everything we buy. Furthermore, we suspect that we should insert it in each purchase order, since the total orders to any firm under a given contract may aggregate more than \$100,000. Therefore, we believe that, for safety's sake, we should insert a clause in every purchase order. It is much simpler to do this by means of a blanket agreement than by attaching the clause to each

order. Hence we are enclosing two copies of such a blanket agreement, with the request that you execute one and return it to us.

As we construe Section 403, the statute is applicable to all orders, though the clause need be inserted only when more than \$100,000 is involved. Therefore we are not altering your rights or liabilities by this blanket agreement, which is only a declaration of your present position. Your execution of it is thus only a formality, but it is a formality which the Government seems to desire and which we are trying to make as painless as possible.

Yours sincerely,

DOUGLAS AIRCRAFT
COMPANY, Inc.

(signed) D. J. BOSIO

Chief of Materiel Division

NM:lm

Enc.

First Around the World

EXHIBIT "B"

(Copy)

(Face of Exhibit "B")

November 14, 1942

Douglas Aircraft Company, Inc.

Materiel Division

P. O. Box 9337, Station S.

Los Angeles, California

Subject: Renegotiation Clause

Gentlemen:

We have received your letter of September 14, 1942, on the subject of renegotiation.

We hereby agree that Special Conditions 42 and 42A printed on the reverse side hereof shall be applicable to all purchase orders which you issue to us under Army and Navy contracts respectively; provided, however, that this agreement shall cover only purchase orders in which you are required by law or by contract to insert such Special Conditions, and shall continue only so long as such requirement may be effective.

Yours sincerely,

MANLOVE & SPAULDING
MFG. CO

(signed) By R. E. SPAULDING

Partner

Note: Execution should be by an authorized officer or a general partner.

In Purch. Nov. 16, '42 AM

(Reverse Side of Exhibit "B")

Special Condition No. 42. Renegotiation under Army Contracts.

(1) Upon the written demand of the Secretary, at such period or periods when, in the judgment of the Secretary, the profits accruing to Seller will renegotiate the contract price to eliminate therefrom

any amount found as a result of such renegotiation to represent excessive profits. The demand of the Secretary shall fix a place for renegotiation and a time for the commencement thereof not later than one year after the date of completion or termination of this contract as found by the Secretary.

(2) Seller will furnish to the Secretary such statements of actual costs of production and such other financial statements, at such times and in such form and detail, as the Secretary may prescribe, and will permit such audits and inspections of its books and records as the Secretary may request.

(3) Any amount of the contract price found as a result of such renegotiation to represent excessive profits shall, as directed by the Secretary, (a) be deducted by Buyer from payments otherwise due to Seller under this contract; or (b) be paid by Seller directly to the Government.

(4) Seller agrees that Buyer shall not be liable to Seller for or on account of any amount paid to the Government by Seller or deducted by Buyer from payments otherwise due under this contract, pursuant to directions from the Secretary in accordance with the provisions of this Article. Under its contract with the Government, Buyer is obligated to pay or credit to the Government all amounts withheld by it from Seller hereunder.

(5) As used in this Article:

(a) The term "Secretary" means the Secretary of [20] War or any duly authorized representative of the Secretary, including the contracting officer:

(b) The terms "renegotiate" and "renegotia-

tion” have the same meaning as in Section 403(b) of the Sixth Supplemental National Defense Appropriation Act, 1942:

(c) The term “this contract” means this contract as modified from time to time.

(6) Seller agrees (a) to include in each fixed-price or lump-sum subcontract hereunder for an amount in excess of \$100,000 the foregoing sections (1) to (5) inclusive, and (b) to make no subdivisions of any contract or subcontract for the purpose of evading the provisions of this section, and (c) to repay to the Government the amount of any reduction in the contract price of any such subcontract which results from renegotiation thereof by the Secretary and which the Secretary directs the Seller to withhold from payments otherwise due under such subcontract and actually unpaid at the time the Seller receives such direction.

The term “subcontract” includes any purchase order from or any agreement with Seller (i) to perform all or any part of the work to be done under this contract, or to make or furnish all or any part of any articles or structures covered by this contract, (ii) to supply any services required directly for the production of any articles or structures covered by this contract, or any component part thereof, not including services for the general operation of Seller’s plant or business, (iii) to make or furnish any articles destined to become a component part of any article covered by this contract, or (iv) to make or furnish any articles [21] acquired by Seller primarily for the performance of

this contract, or this contract and any other contract with the United States. The term "articles" includes any supplies, materials, machinery, equipment or other personal property.

Special Condition No. 42A. Renegotiation under Navy Contracts.

(a) At any time, when in the judgment of the Secretary, the profits accruing to Seller under this Purchase Order can be determined with reasonable certainty, the Secretary and Seller, upon the written demand of the Secretary, will renegotiate the price with a view to eliminating such profits as are found as a result of such negotiation to be excessive.

(b) In the event that such renegotiation results in a reduction of the price, the amount of such reduction shall, as may be directed by the Secretary, be deducted by Buyer from payments to Seller under this Purchase Order; or be paid by Seller directly to the Government; or be repaid by Seller to Buyer.

(c) Seller agrees that Buyer shall not be liable to Seller for or on account of any amount repaid to Buyer or paid to the Government by Seller or deducted by Buyer from payments to Seller pursuant to directions from the Secretary in accordance with the provisions hereof. Under its contract with the Government, Buyer is obligated to pay or credit to the Government all amounts repaid by or withheld from Seller hereunder.

(d) The term "Secretary" as used herein means the Secretary of the Navy and his duly authorized representatives. [22]

[Title of District Court and Cause.]

AFFIDAVIT OF SERVICE BY MAIL

United States of America,

Southern District of California—ss.

Dorothy Jane Salk, being first duly sworn, deposes and says:

That she is a citizens of the United States and a resident of Los Angeles County, California; that her business address is 600 Federal Building, Los Angeles, California; that she is over the age of eighteen years, and not a party to the above-entitled action;

That on September 27, 1944, she deposited in the United States Mails in the Post Office at Temple and Main Streets, Los Angeles, California, in the above-entitled action, in an envelope bearing the requisite postage, a copy of Answer of Douglas Aircraft Company, Inc., address to Messrs. Jos. I. McMullen and Leo R. Friedman, 935 Russ Building, San Francisco 4, California, at which place there is a delivery service by United States Mail from said post office.

DOROTHY JANE SALK

Subscribed and Sworn to before me, this twenty-seventh day of September, 1944.

EDMUND L. SMITH,

Clerk, U. S. District Court, Southern District of California

By E. M. ENSTROM, Jr.

Deputy.

REW:ds

9-27-44

[Endorsed]: Filed Sept. 27, 1944. [23]

[Title of District Court and Cause.]

NOTICE

To: Jos. I. McMullen, Esq., Leo R. Friedman, Esq.,
935 Russ Building, San Francisco 4, California

To: T. C. McMahon, Secretary, Douglas Aircraft
Company, Inc., 3000 Ocean Park Boulevard,
Santa Monica, California

You will please take notice that on Monday, the 18th day of December, A. D. 1944, at the hour of 10 o'clock in the forenoon of said day, or as soon thereafter as counsel may be heard, the undersigned attorneys for the United States of America will appear before the Honorable Ben Harrison in the courtroom usually occupied by him in the United States Court House, Los Angeles, California, and will then and there present the motion of the United States for leave to intervene in the above-entitled cause; the answer of the United States as intervenor to the complaint in said cause; and will [24] then and there ask the Court to enter an order allowing intervention by the United States, copies of which said motion, answer, and proposed order are hereto annexed.

FRANCIS M. SHEA,

Assistant Attorney General

CHARLES H. CARR,

United States Attorney

RONALD WALKER,

Assistant United States
Attorney

ROBERT E. WRIGHT,
Assistant United States
Attorney.

[Endorsed]: Filed Nov. 17, 1944. [25]

[Title of District Court and Cause.]

RESPONSE TO CERTIFICATION AND MO-
TION BY UNITED STATES TO INTER-
VENE

Comes now the United States of America by its Assistant Attorney General Francis M. Shea and its United States Attorney Charles H. Carr and says:

1. The United States of America, pursuant to the Act of August 24, 1937 (28 U.S.C. 401) and Rule 24 of the Federal Rules of Civil Procedure, moves to intervene and become a party herein for the purposes and with all the rights provided by said Act of August 24, 1937, and by said Rule 24, on the following grounds:

(a) That the constitutionality of an Act of Congress, the Renegotiation Act, [Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942 (Public [26] 528, 77th Congress), approved April 28, 1942, as amended by Section 801 of the Revenue Act of 1942 (Public 753, 77th Congress), approved October 21, 1942; by the Military Appropriation Act, 1944 (Public 108, 78th Congress), approved July 1, 1943; by Public 149, 78th Congress, approved July 14, 1943; and as amended

in full by Section 701 (b) of the Revenue Act of 1943 (Public 235, 78th Congress), enacted February 25, 1944] affecting the public interest is drawn in question in this action and neither the United States, nor any agency thereof, nor any officer or employee thereof, as such officer or employee, is a party hereto; and

(b) That in accordance with Rule 24 (b)(2) of the Federal Rules of Civil Procedure, the United States has claims and defenses which present questions both of law and of fact which are common to the main action. The intervention of the United States will not unduly delay or prejudice the adjudication of the rights of plaintiffs or defendant in this action.

2. Annexed hereto in accordance with Rule 24(c) of the Federal Rules of Civil Procedure is a pleading entitled "Answer of the United States." The United States moves that said pleading be deemed the appearance of the United States in support of the constitutionality of the Act of Congress herein drawn in question, and in opposition to all pleadings, motions and proceedings of the parties hereto that have been or may be made in so far as said pleadings, motions or proceedings are based on the contention that said Act of Congress is in any respect, or in any application, unconstitutional; and that said pleading be deemed the appearance of the United States for the purpose of asserting [27] its claims and defenses under the Federal Rules of Civil Procedure, and in opposition to all pleadings, motions and proceedings of the parties hereto that

have been made or may be made herein in so far as said pleadings, motions or proceedings relate to said claims or defenses.

3. The United States moves for leave to make such motions and take such other proceedings as may be appropriate and lawful and to present evidence in support of the allegations of its answer and as the Act of August 24, 1937 provides.

FRANCIS M. SHEA,

Assistant Attorney General

CHARLES H. CARR,

United States Attorney

RONALD WALKER,

Assistant United States
Attorney

ROBERT E. WRIGHT

Assistant United States
Attorney.

[Endorsed]: Filed Dec. 18, 1944. [28]

[Title of District Court and Cause.]

ORDER ALLOWING INTERVENTION
BY UNITED STATES

This cause came on to be heard on the motion of the United States to intervene and for other relief, and the Court being satisfied that the United States has the right to intervene and become a party herein under the provisions of the Act of August

24, 1937 (28 U.S.C. 401), and under the provisions of Rule 24 of the Federal Rules of Civil Procedure, It Is Ordered:

(1) That the motion of the United States is in all respects granted;

(2) That the United States is hereby made a party to this cause for the purposes and with all the rights provided by said Act of August 24, 1937, and by the Federal Rules of Civil Procedure, and that [29] the United States shall receive notice of all proceedings herein;

(3) That the Answer of the United States, annexed to said motion, is deemed the appearance of the United States in support of the constitutionality of the Act of Congress herein drawn in question, to wit, the Renegotiation Act; and in opposition to all pleadings, motions and proceedings of the parties hereto that have been or may be made insofar as said pleadings, motions or proceedings are based on the contention that said Act of Congress is in any respect, or in any application, unconstitutional; and that such Answer of the United States is deemed the appearance of the United States for the purpose of asserting its claims and defenses under Rule 24 (b)(2) of the Federal Rules of Civil Procedure; and in opposition to all pleadings, motions or proceedings of the parties hereto that have been made or may be made herein insofar as said pleadings, motions or proceedings relate to said claims or defenses;

(4) That leave is granted to the United States to make such motions and take such other proceed-

ings as may be appropriate and lawful and to present evidence at the trial in support of the allegations of its answer and in the manner provided by said Act of August 24, 1937.

Done in open court this 18th day of Dec., 1944.

BEN HARRISON

United States District Judge

[Endorsed]: Filed Dec. 18, 1944. [30]

[Title of District Court and Cause.]

ANSWER OF THE UNITED STATES

The United States of America, intervener herein, for its pleading in intervention alleges as follows:

1. By certificate dated September 12, 1944, the Honorable Ben Harrison, Judge of the United States District Court, certified to the Attorney General, pursuant to the Act of August 24, 1937 (28 U.S.C. 401), the fact that the constitutionality of the Renegotiation Act, an Act of Congress affecting the public interest, is drawn in question herein.

2. Except by this intervention neither the United States nor any agency thereof nor any officer or employee thereof, as such officer or employee, is a party hereto. [31]

3. The constitutionality of the Renegotiation Act has been drawn in question by the allegations of the complaint.

4. The Renegotiation Act affects the public interest for the following reasons among others:

(a) In the light of the experience acquired in the Revolutionary War, the Civil War and the World War, Congress has concluded that the Renegotiation Act is the fairest and most effective method for eliminating excessive war profits.

(b) Effective control of war profits is essential to reduce the tax burden of the nation and to maintain public morale.

(c) The Renegotiation Act is an integral and indispensable feature of the procurement program of the Services and of the program for the control of wartime inflation.

(d) During the period from the enactment of the statute on April 28, 1942, to September 16, 1944, the United States has obtained refunds of excessive war profits in an amount greater than \$2,500,000,000, prior to tax adjustment. In 97.5% of the cases considered during this period, the contractor agreed to the determination made by the renegotiating officials. Similar returns to the United States can be expected under the statute during the remaining period of its operation.

(e) The Renegotiation Act is the expression of the fixed purpose of the Congress and the nation to eliminate war profiteering. [32]

First Defense

5. The Renegotiation Act was enacted pursuant to the war powers of the Congress. It is constitutional and valid and all action taken pursuant thereto in determining the amount of excessive

profits realized by plaintiffs was in all respects lawful.

6. The Declarations of War with Germany, Italy and Japan required the production of the weapons of war, the procurement of equipment and supplies for troops, the construction of camps and camp facilities and the procurement of the instruments of communication and transportation in the largest possible quantity with the greatest possible speed. The full industrial capacity of the United States had to be converted immediately to the production of war material and to meet war objectives. The extent of the procurement problem is indicated by the fact that during the four months of July, August, September and October, 1942, the War Department alone entered into over 1,400,000 contracts. In January, 1942, the total dollar value of contracts executed for war purposes amounted to more than \$9,000,000,000 and in the remaining months of the fiscal year 1942 this figure never fell below \$4,800,000,000. On June 30, 1942, the outstanding obligations of the United States for war supplies and war facilities amounted to nearly \$43,000,000,000. Total expenditures of the War and Navy Departments for the fiscal year ending June 30, 1942, amounting to nearly \$23,000,000,000, exceeded the total military and naval expenditures of the United States from 1789 through the end of the World War.

7. The necessity for procuring war material adequate in quantity and available in time to permit this nation to avert grave military reverses re-

quired that ordinary procurement procedures be drastically modified. Negotiation of contracts was substituted for advertising for bids; letters of intent and letter contracts were widely employed to allow manufacturers to begin production prior to [33] the execution of formal agreements; subcontracting and wide-spread distribution of war orders were required to utilize the full industrial capacity of the nation and procurement officials in the field were given full and final authority to execute contracts in very large amounts. The difficulties were enormously increased by the fact that modern warfare, mechanized and amphibious, has forced the development, production and use of hitherto unknown weapons and supplies. Furthermore, shortages and dislocation of labor and materials required wholesale revisions in established methods of production.

8. Under these circumstances accurate pricing was impossible. Many of the supplies and weapons were entirely new and as to these there was and could be no guiding cost or price experience. Many contractors were required to produce articles which they had never produced before and were thus required to convert their plants and to retrain their labor forces. Quantities, rates of delivery and specifications were and had to be modified in the light of battle experience. These uncertainties were further increased by shortages and dislocation of labor and material supply. Under such circumstances, the contractor was entitled to and did receive prices which would protect him against these

innumerable hazards to production, although it was recognized that as experience was acquired, as conversion problems were solved, as labor was trained, as lines of supply were established, as design and specifications were crystalized, and as mass production was achieved, the cost of production would be greatly decreased and, therefore, that very large profits could be expected.

9. Renegotiation developed as the solution to the problem of meeting the procurement needs of the armed forces with the speed necessary to achieve military objectives, and at the same time eliminating excessive war profits which would place an undue burden upon the [34] taxpayers of the nation, impair the national morale and constitute a threat of war-time inflation. Prior to the enactment of the statute there had been numerous instances of voluntary refunds to the Government of excessive profits and of voluntary renegotiation and revision of contract prices. The War and Navy Departments had, prior to the statute, established cost inspection divisions and had designated renegotiating officials whose duty it was to advise contracting officers concerning fair pricing for future contracts and to renegotiate prices under existing agreements. The Renegotiation Act made obligatory and gave the force of law, with power in the Government to make unilateral determination and with such other modifications as the Congress thought desirable, to the practice which was being developed by the Services and responsible members of the business community.

10. No rigid definition of excessive profits was possible. In fairness to the contractor and to the public, it was necessary that the ultimate price and the ultimate profit to be fixed by an exercise of judgment in the light of the conditions peculiar to the individual contractor. Consideration had to be given to a great variety of circumstances, including the contractor's economy in the use of labor, plant facilities and raw materials, the contractor's efficiency in achieving quantity production at reduced cost, the war contribution of the contractor by invention or by development of manufacturing techniques, the quality and complexity of the item produced, the extent and character of subcontracting, the nature and amount of Government financing, the contractor's cooperation in meeting the changing problems of war production, the risks assumed by the contractor because of close pricing, large inventories, cut-backs in orders or modifications of specifications and such other factors as might at the time of the profit determination prove to be appropriate.

11. In order to achieve the purposes for which the statute was passed and to eliminate, so far as possible, unfair discrimination between contractors the Congress determined that it was necessary that [35] the Act apply to contracts in existence on the date the legislation became effective, that is on April 28, 1942. On that date there were outstanding uncompleted war contracts under which the United States had obligations in excess of \$50,000,000,000. It was in connection with these early contracts that

the probability of excessive profits was greatest and accordingly, that the need for renegotiation was greatest.

12. All the considerations which required renegotiation of prices and profits arising from prime contracts apply with equal force to subcontracts.

13. In view of the great variety of war contracts and in order that the accounting burden might not defeat the ultimate objectives of the statute and in order that the renegotiation law itself should not by its rigidity impede the procurement of war supplies, it was necessary and advisable that the procuring agencies be empowered to act upon the classification of contracts established by the statute.

Second Defense

14. This Court has no jurisdiction of any issue as to which the Tax Court is given jurisdiction by Section 701 of the Revenue Act of 1943 (Pub. 235, 78th Cong.). That section permits any contractor or subcontractor dissatisfied with the Government's determination of his excessive profits to obtain in the Tax Court of the United States a determination de novo of the amount of such profits and the Tax Court is given "exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency." Plaintiffs have not filed a petition in the Tax Court for such redetermination and the time for filing such a petition has expired. [36]

Third Defense

15. The complaint fails to state a claim upon which relief can be granted.

Fourth Defense

16. The United States admits the allegations contained in paragraph I of the complaint; admits the allegations contained in paragraph II of the complaint; admits that the value of the property and property rights involved herein exceeds the sum of \$3,000, exclusive of costs and interest, but alleges that it is informed and believes that such value is not more than \$27,580.80; alleges that it is informed and believes that the defendant did become indebted to the plaintiffs in the sum of \$27,580.80 and alleges that by reason of the orders and determinations made by Robert P. Patterson and described in the complaint said sum of \$27,580.80 is not now owing to the plaintiffs but is now owing to the United States; admits that an actual controversy exists with relation to the rights of the parties and pertaining to the payment of the alleged indebtedness; admits the allegations in paragraphs V(a), V(b), V(d) and V(e) of the complaint; admits that plaintiffs were and are engaged in the manufacture, production and sale of mechanical fittings and of airplane parts, manufactured and produced in the City of Los Angeles, County of Los Angeles, State of California; denies that all of plaintiffs' business for the fiscal year ending December 31, 1942 was the basis on which the order of February 2, 1944 was made and alleges that only

so much of plaintiffs' business as was subject to renegotiation pursuant to the Renegotiation Act was the basis of such order; admits that plaintiffs have made available to the United States and to its agents charged with the administration of the Renegotiation Act books, papers, records, documents and accounts; alleges that it is informed and believes that on or about September 14, 1942 defendant prepared and sent to plaintiffs a letter dated September 14, 1942, a true [37] copy of which is attached hereto as Exhibit "A", and plaintiffs on November 14, 1942 replied by letter dated that day, a true copy of which is attached hereto as Exhibit "B"; admits that by virtue of the order made by the Under Secretary of War on May 1, 1944, defendant is without right, power or authority to pay to plaintiffs the sum of \$27,580.80 or any other sum subject to that order.

The United States denies each allegation of the complaint not admitted, qualified or specifically denied.

Fifth Defense

17. With respect to all matters in controversy in this suit, all action taken by Henry L. Stimson and Robert P. Patterson, and by all persons acting for them or under their direction or on their behalf was taken pursuant to and was authorized or required by the Renegotiation Act.

Wherefore, the United States prays that the contention that the Renegotiation Act is unconstitutional be rejected and that the Court adjudge

and declares that such Act is constitutional and that the United States have such other and further relief as to the Court shall seem just and proper.

FRANCIS M. SHEA,

Assistant Attorney General

CHARLES H. CARR,

United States Attorney

RONALD WALKER,

Assistant United States

Attorney

ROBERT E. WRIGHT,

Assistant United States

Attorney

District of Columbia,

City of Washington—ss.

Robert P. Patterson, being duly sworn, deposes and says that he is and at all times since December 19, 1940, has been the Under Secretary of War of the United States; that he has read the foregoing answer and knows the contents thereof, and that the matters therein set forth are true, save that matters averred upon information and belief are believed to be true to the best of affiant's knowledge.

ROBERT P. PATTERSON

Sworn to before me this 31st day of October, 1944.

[Seal]

ANNA C. LANIGAN,

Notary Public.

My commission expires June 15, 1946.

[Printer's Note]: Exhibits "A" and "B" are set out in full at pages 25 and 26.

[Endorsed]: Filed Dec. 18, 1944.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR SUMMARY
JUDGMENT

To: Joseph I. McMullen, Esq.; Leo R. Friedman,
Esq., 935 Russ Building, San Francisco 4, Cali-
fornia

You will please take notice that on February 19, 1945, at the hour of 10 o'clock in the morning of said day, the undersigned attorneys for the defendant in the above-entitled cause will appear before the Honorable Ben Harrison, one of the Judges of the District Court of the United States in and for the Southern District of California, in the courtroom usually occupied by him in the United States Court House at Temple and Main Streets in the City of Los Angeles, and will then and there present the motion of the defendant for a summary judgment; which said motion has been filed in the office of the Clerk of said court and a copy of which said motion is attached hereto.

FRANCIS M. SHEA

Assistant Attorney General

CHARLES H. CARR,

United States Attorney.

RONALD WALKER,

Assistant United States Attorney.

ROBERT E. WRIGHT,

Assistant United States Attorney.

[Endorsed]: Filed Jan. 23, 1944.

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

Come now the defendant, Douglas Aircraft Company, Inc., and the intervener, the United States of America, and move for summary judgment for defendant on the ground that there is no genuine issue as to any material fact and defendant is entitled to judgment as a matter of law and on the further ground that the complaint fails to state a claim upon which relief can be granted. The court lacks jurisdiction to try in this action any issue as to the amount of the excessive profits received by plaintiff. (Revenue Act of 1943, Public 235, 78th Cong., 2d Sess., Title VII, Sec. 403(e)).

The motion is based upon the verified answer of the United States, the affidavit of Robert P. Patterson, the affidavit of H. Struve Hensel, and the pleadings, files and records in this case.

FRANCIS M. SHEA,
Assistant Attorney General

CHARLES H. CARR,
United States Attorney.

RONALD WALKER,
Assistant United States Attorney.

ROBERT E. WRIGHT,
Assistant United States Attorney.

[Title of District Court and Cause.]

AFFIDAVIT OF SERVICE BY MAIL

United States of America

Southern District of California—ss.

M. Jeanne Black, being first duly sworn, deposes and says:

That she is a citizen of the United States and a resident of Los Angeles County, California; that her business address is 600 Federal Building, Los Angeles, California; that she is over the age of eighteen years, and not a party to the above-entitled action;

That on January 23, 1945 she deposited in the United States Mails in the Post Office at Temple and Main Streets, Los Angeles, California, in the above-entitled action, in an envelope bearing the requisite postage, a copy of Motion for Summary Judgment and Notice of Motion addressed to Messrs. Joseph I. McMullen and Leo R. Friedman, 935 Russ Building, San Francisco 4, California, at which place there is a delivery service by United States Mail from said post office.

M. JEANNE BLACK

Subscribed and sworn to before me, this twenty-third day of January, 1945.

[Seal]

EDMUND L. SMITH

Clerk, U. S. District Court,
Southern District of
California

By JOHN A. CHILDRESS

Deputy

REW:mjb

1-23-45

[Endorsed]: Filed Jan. 23, 1944.

[Title of District Court and Cause.]AFFIDAVIT OF ROBERT P. PATTERSON
IN SUPPORT OF MOTION FOR
SUMMARY JUDGMENT

District of Columbia—ss.

Robert P. Patterson, being duly sworn, deposes and says:

1. I am Under Secretary of War of the United States and have held that office, which was created by the Act of December 16, 1940, 54 Stat. 1224, since December 19, 1940. From July 30, 1940 to December 19, 1940 I was The Assistant Secretary of War.

2. By authority of various statutes and by various delegations of authority from The Secretary of War, I am, and have been both as Under Secretary and as The Assistant Secretary of War, charged with the supervision of the procurement of all military supplies and of other business of the War Department and the Army pertaining to production and procurement.

3. The statements made in this affidavit are based upon information acquired by me in my offi-

cial capacity and which I believe to be true and accurate.

Preliminary Statement

4. Wartime procurement for the military establishment differs radically from procurement in times of peace. Speed in production at once becomes all-important. Industry is called upon to produce an entire complex of new products, constantly changing in design and purpose. Quantities of both old and new products, far beyond those previously manufactured, are suddenly demanded, and in the shortest possible time. For the production of these needed items, existing plants, machinery and equipment have to be converted from producing peacetime civilian goods to meet the different and expanded needs of the armed forces. Even the marginal producers have to be used in order to meet these needs. In addition, hundreds of new plants, new machinery and new equipment have to be constructed, installed, and put to work. The nation's manpower has to be reallocated, almost overnight, to adjust to the gaps caused by the transfer of millions from production to the armed forces, and to the springing up of new industries and new areas of production. Enormous dislocations in transportation, and in the supply of raw materials have to be ironed out.

5. The necessary result of this combination of circumstances is that the war procuring agencies cannot use normal methods of procurement. The pressing need for speed requires the abandonment of drawn-out negotiation and the careful surveys of

all relevant factors which sound purchasing would otherwise require. Competition necessarily wanes and no longer offers an adequate guide to the prices which should be paid. Above all, the forecasting of costs of production becomes, in large measure, a matter of informed guessing rather than of real cost analysis. This is true in the case of new products, new plants, and new producers; it is likewise true, though perhaps in lesser degree, wherever the quantities to be manufactured are sharply increased over pre-war amounts. Accordingly, advance prices quoted in good faith by manufacturers in a large number of cases have little relation to costs actually experienced in the course of production. Furthermore, many manufacturers feel unable to quote firm prices without including reserves to cover many contingencies the occurrence of which might skyrocket their costs, and so overturn all their estimates.

6. These were the conditions of wartime procurement, after December 7, 1941, and the War Department had to force its procurement activities into their mold. Efforts were made, of course, to develop contractual devices which would minimize the paramount difficulty in estimating production costs. The cost-plus-fixed-fee contract was used where unavoidable, but this form has the disadvantage of removing financial incentives to efficiency and of imposing a heavy burden of auditing upon the Government and the contractor. Escalator clauses, permitting prices to be adjusted according to fluctuations in indices of labor and material costs, were also used but proved unworkable. Letters of

intent, under which manufacture was commenced prior to the negotiation of a formal contract, helped to speed production, but could not, of course, solve the ultimate problem of decreasing costs and preventing excessive profits.

7. Shortly after the declarations of war, both the legislative and the executive branches of the Government realized that excessive wartime profits were certain to accrue unless counter measures were taken. The evil effect of such wartime excessive profit on the morale of the fighting forces and the civilian population, as well as the unnecessary financial burden upon the Government, could not be ignored. The example of the last war was still fresh. Many war contractors realized the dangers and inequities resulting from such excessive profit, and some of them made refunds of excessive profits or voluntarily reduced their prices. In the spring of 1942, the War Department developed cost analysis units to check, so far as practicable, on production costs, and set up a price adjustment board to negotiate with contractors for voluntary price reductions and refunds of past payments. Tentative policies as to what profits were excessive were established and meetings with contractors had. At the same time, there came into use contract clauses providing for the renegotiation or redetermination of contract prices after an initial period of production had laid a basis for the proper estimation of costs. We hoped that these means would keep incentives to efficiency alive and at the same time would tend to eliminate undue profits such as were then coming to light.

8. The Congress apparently felt, however, that these contractual measures, resting as they did upon the voluntary cooperation of a relatively small number of war contractors, did not provide enough certainty that excessive profits would be eliminated. The Vinson-Trammel Act, limiting profits on aircraft and ship construction, had been repealed in 1940, but an effort was made to revive it. In March, 1942, the War Department and the War Production Board opposed such legislation on the ground that a flat percentage profit limitation would impede production and would be unfair to many contractors and too generous to others. After the Case amendment imposing such a flat percentage limitation on profits from war contracts had been adopted by the House of Representatives late in March, 1942, the armed services and the War Production Board offered a substitute proposal giving statutory authority to the process of voluntary renegotiation which had been developing. Congress adopted the principle of renegotiation with which the armed services were in accord (rather than the principle of a flat percentage limitation of profits), and it also endowed the procuring agencies with power to determine excessive profits when no bilateral agreement could be reached with the contractor. I believe that this addition by the Congress of the power of unilateral action was a wise and a necessary one, and that without it renegotiation would not have accomplished anything like the results that have been achieved.

9. The purpose of this affidavit is to present the

facts showing in greater detail, (a) the nature and extent of the procurement problems of the Army after the declaration of war, (b) the need for renegotiation and limitation of profits of war contractors and the steps which had been taken in that direction prior to the enactment of the renegotiation statute, and (c) what statutory renegotiation has accomplished.

The Army's Procurement Problems Subsequent to the Declaration of War

10. Immediately after the attack on Pearl Harbor, on December 7, 1941, the War Department's procurement program was sharply accelerated to meet the new requirements imposed upon the country and the Army by the sudden involvement of the United States in the war. The defense procurement program had been large, but the effort was minor in comparison with that necessitated by the demands of active warfare. Supplies, equipment, housing, ammunition, and weapons had to be secured, in the least possible time, for our rapidly expanding armed forces, and for the anticipated needs of a war to be fought on two sides of the globe. In addition, increased supplies for the nations with which we were allied had to be produced with the greatest possible speed. All phases of procurement were stepped up: production of the weapons of war, such as guns, planes, tanks; construction and equipment of camps; procurement of equipment and supplies for the troops; construction of plant facilities; production of the means of communication and transportation.

11. The extent of the problem facing the procurement agencies can be judged from the goals set by the President in his message to Congress of January 6, 1942. The President stated:

“I have just sent a letter of directive to the appropriate departments and agencies of our government ordering that immediate steps be taken:

“First to increase our production rate of airplanes so rapidly that in this year 1942 we shall produce 60,000 planes, 10,000 by the way, more than the goal that we set a year and a half ago. This includes 45,000 combat planes, bombers, dive bombers, pursuit planes. The rate of increase will be maintained, continued, so that next year, 1943, we shall produce 125,000 planes, including 100,000 combat planes.

“Secondly, to increase our production rate of tanks so rapidly that in this year, 1942, we shall produce 45,000 tanks, and to continue that increase so that next year, 1943, we shall produce 75,000 tanks.

“Third, to increase our production rate of anti-aircraft guns so rapidly that in this year, 1942, we shall produce 20,000 of them, and to continue that increase so that next year, 1943, we shall produce 35,000 antiaircraft guns.

“And fourth, to increase our production rate of merchant ships so rapidly that in this year, 1942, we shall build 8,000,000 deadweight tons, as compared with a 1941 completed production of 1,100,000. And finally, we shall continue that increase so that next

year, 1943, we shall build 10,000,000 tons of shipping."

Illustrative of the tremendous undertaking facing both American industry and the procurement agencies is the fact that the total number of planes (military, commercial, and private) produced from 1903 to 1940 was some 33½ per cent less than the number scheduled for the year 1942 alone, and that procurement of planes for the Army during 1942 was over 250% greater than in 1941. For the fiscal year ending June 30, 1942, the money appropriated for War Department procurement and construction was more than six times the amount appropriated in the fiscal year 1941. One-third of the total was appropriated by the Congress in the first half of the fiscal year 1942, before the United States had been attacked; after Pearl Harbor, the Congress tripled the new procurement funds made available earlier in the fiscal year.

12. To fulfill the requirements of this expanded war program, a vast number of contracts had to be made, as quickly as possible, for supplies, weapons, and munitions of all kinds. Attached as Exhibit A is a chart (based on information furnished by the War Production Board) showing the number and dollar value of contracts for all types of war materials entered into each month from July 1941 through June 1942 by the various procuring agencies. The tremendous increase which occurred in January 1942 and continued through the remaining months of that fiscal year is clearly shown by this

chart. In November, 1941, the total dollar value of such contracts was \$1,506,000,000; in December it jumped to \$3,131,000,000; and in January 1942 to \$9,456,000,000; in the remaining months of the fiscal year it never fell below \$4,800,000,000. The chart, it should be noted, understates both the total number of contracts and their total dollar value, since it excludes (1) contracts with a value of less than \$50,000 (of which there were a vast number), (2) contracts for subsistence, and (3) construction contracts. An idea of the comparison between the total number of contracts entered into by the War Department prior to Pearl Harbor and thereafter can be gained from the fact that the number of contracts for the fiscal year ending June 30, 1941, was 667,364, while that for the four months of July, August, September, and October 1941 alone was 1,408,141. All these figures concern only prime contracts, but the vast stimulating effect of this expanded volume of prime contracts upon subcontracting of all tiers is readily apparent. On December 31, 1941, War Department obligations for supplies and new capital facilities amounted to more than 9 billion dollars, but on June 30, 1942, they amounted to nearly 43 billion dollars. War Department expenditures for delivered supplies were nearly 4 billions on December 31, and were more than 13 billions on June 30. In the last six months of the fiscal year ending June 30, 1942, War Department contractual activity and the delivery of supplies were four times greater than in the first six months. Some conception of the vast scope of

the procurement activity of the armed services after the attack on Pearl Harbor can be gained from the fact that the total expenditures of the War and Navy Departments for the one fiscal year ending June 30, 1942 (\$22,905,000,000) considerably exceeded the total military and naval expenditures of the Government from 1789 through the end of World War I.

13. To meet these accelerated demands, the armed forces had to call, in largest measure, upon private industry which, prior to December 7, 1941, was devoting only 25% of its total production to defense work, and of this amount, by far the largest proportion resulted from the use of existing idle capacity and the establishment of new facilities rather than from the conversion of existing facilities geared to civilian production. Little stoppage of civilian production had occurred prior to December 1, 1941. If the imperative needs of the armament program were to be satisfied, wholesale conversion of existing production facilities to a war economy would have to occur. By the end of 1942, the proportion of manufacturing industry devoted to war production amounted to upwards of 45%, and presently this percentage is estimated at 60%. Some of this increase is, of course, attributable to the continued construction and use of new facilities, but the greater part of it has come from conversion of existing facilities since December 1941.

14. The armed forces were thus forced to grapple with major difficulties stemming from (a) the greatly increased demands for supplies of all types,

(b) the accelerated program requiring immediate production, and (c) the urgent and rapid conversion of the great mass of American industry to war work and the large-scale use of new facilities. Other acute problems were caused by (d) the demand for new products not previously manufactured, and by the constant modification of specifications to reflect improvements in design or changing needs, and (e) by the current uncertainty in the amounts of materiel to be procured, and the grave difficulties in the supply and cost of labor and materiel which were daily arising at that time:

(a) The greatly increased demand for supplies made the accurate forecasting of costs very difficult. Starting costs were bound to be higher than those incurred after mass production had begun; but the extent to which quantity production would bring a sharp drop in costs could not be estimated either by the Government or by contractors, and the latter were naturally very cautious in prophesying about their future costs. This was frequently true in the case of standard articles previously manufactured in small quantities and was uniformly true in the case of new products.

(b) The urgent need for placing orders and starting production as soon as possible placed the importance of speed far above thorough analysis or careful negotiations. Time was of the essence, and the Government personnel entrusted with negotiation and procurement were, of necessity, too few and too overburdened to follow the normal procedure of careful procurement. There was simply no time to

collate and check the cost information which in less abnormal times would be required; and, of course, such cost information pertinent to wartime production was frequently nowhere obtainable.

(c) The conversion of peacetime facilities to war work meant that cost data for the new production were unavailable, even for established plants. And in the hundreds of new plants producing war goods, only the roughest guess as to the costs of manufacturing which would be experienced during actual production could be made. Marginal producers, and those with no experience with the product or with the greatly increased quantities they would be called upon to produce, had to be used.

(d) War on the scale and under the conditions we are fighting calls for unceasing development, production, use, and improvement of countless new supplies and weapons. The demands of amphibious warfare, for instance, led to the development of amphibian boats and cargo carriers. The mechanization of modern warfare forced the development and rapid production of such items as tanks and motorized gun carriers as well as of the weapons employed against them: anti-tank guns and grenades, armor-piercing ammunition, self-propelled mounts, and anti-aircraft guns. The spurt and rapid changes in aircraft development are common knowledge, as is the growth of communication and detection devices. Changes in design and material also frequently resulted from shortages of previously used components. The use of steel had to be severely limited wherever a less critical material could be

substituted. Motor vehicle cargo bodies, for example, were converted from steel to wood. Acute shortages of copper and brass led to other changes in accepted design. Great use was made of plastics in order to release critical metals. This activity can be partly epitomized in the summary statistic that during the fiscal year 1942 approximately 1,200 Army specifications were reviewed, and revised or approved, and about 425 specifications were completely cancelled.

(e) Material and labor shortages were acute in the spring of 1942. The consequence was that it was generally difficult, except within the widest limits, to establish accurate schedules for the production of supplies. The Army's requirements had to be drastically reduced, in the months from February to June, 1942, because of these factors, and these changes and reductions were reflected in the War Department's procurement program. An equally important consequence was the difficulty of gauging both the costs and the time of performance because of the shortages and anticipated rise in the costs of labor and materials.

15. All these factors made advance pricing a haphazard process in which the war procurement agencies could put little trust. The situation with which we were faced is well summarized in the following two statements (one by a Government agency and the other by a large war contractor) with which I am in full accord and which I believe to be an accurate description of the procurement situation as it existed after the coming of the war. The following is an excerpt from the Introduction to the Renego-

tiation Regulations issued by the War Contracts Price Adjustment Board:

“The war program creates problems of procurement and production unprecedented in scale and complexity. War materials of all kinds are required in enormous quantities with the greatest possible speed. The munitions program expanded with such rapidity that contracting officers were hard pressed to place contracts in time to meet the accelerated requirements. In order to avoid delay, they had to make contracts without adequate data. Obtaining the material was the first issue. Many contractors were asked to produce articles which had never been produced before and which were subject to frequent change. Others were asked to produce articles which were new to them. Still others, who had produced articles in small quantities, were asked to produce them in amounts far beyond their previous experience. Quantities needed, the rates of delivery and specifications had often to be revised in the light of experience and the demands of war. Shortages of material, priorities, and allocations increased the uncertainty of production.

“Besides these circumstances, contractors and contracting officers were frequently unable to make an accurate forecast of costs on which to base prices. During the period of transition, costs were certain to be high. New facilities had to be obtained, new personnel employed and trained to new methods and new sources of supply developed. How long this would take was itself uncertain. After the contrac-

tor got into production, greater efficiency, improved methods, and increased volume could be expected to reduce costs sharply.”

The following are excerpts from a report by the General Motors Corporation, in September 1943, to the War Department Price Adjustment Board:

“With the advent of the war-production program, the automatic check on pricing policy which had been furnished by competition during peacetime could no longer be relied upon. The Corporation was obliged to undertake the manufacture of many products which were entirely foreign to its own past operations. In many instances, these products had not been produced by any manufacturers in the volume contemplated by the war program. As a result, there was no ready-made yardstick against which the Corporation could measure proposed prices, and it became necessary to rely largely upon the judgment of the several general managers of the operating divisions and the Government contracting officers, as well as whatever limited experience might be available from other producers, as to the reasonableness of the cost estimates and prices submitted. In certain cases, the only practical solution of the pricing problem has been to insert clauses into contracts providing that prices would be reviewed as soon as representative cost experience had been obtained as a result of volume production.”

“Under these circumstances, it has been impossible to predict with any degree of certainty what

the operating results of particular contracts might ultimately be. It therefore became imperative for the Corporation to establish as soon as possible a basic pricing policy which would take into account these unusual conditions and insure that proper and effective pricing control would be obtained. In establishing this policy, the primary considerations were two-fold. First, it was recognized that in producing war material, the checks of normal competition had been removed, and that the peacetime conception of desirable profit margins, as previously described, had to be modified. Second, it was considered essential to maintain, as far as possible, the Corporation's normal method of doing business on a decentralized basis, with primary responsibility for contracting, pricing and production resting upon the divisional general managers, subject to the over-all general policies of the Corporation. * * *

“The policy of taking contracts on a fixed-price basis whenever practicable was adopted (despite the increased risk) because of the greater incentive to efficient operation afforded by this type of contract as compared with the cost-plus-fixed-fee type. However, it was recognized that the divisions were undertaking the production of war materials which were not only new to the Corporation, but had not been manufactured by anyone on a ‘mass-production’ basis. Therefore, there was always a possibility that initial cost estimates on certain contracts, even though they appeared reasonable to the divisional general managers and to the Government contracting officers at the time the estimates were pre-

pared, might turn out to be higher than actual costs of production as volume increased, when designs were changed, and as manufacturing experience was obtained. * * * ”

16. A graphic illustration of the way in which all the factors of uncertainty listed above combined to make the advance estimation of costs extremely difficult in 1941 and 1942 is furnished by the experience of the General Motors Corporation. That company is one of the largest peacetime manufacturers of automotive products, its accounting and auditing procedures are superior, and its ability to forecast the costs of manufacture of automotive products would far outrun that of most other producers. Nevertheless, as the company itself fully realized (see paragraph 15 above), even it was in no position to estimate its costs with any acceptable margin of accuracy. General Motors accepted contracts containing redetermination provisions, under which an original price based on the best available estimate of costs was established, with revisions made after the costs of a preliminary run of 1,000 units and a test run of a further 1,000 units were available. The price for the remainder of the contract was determined on the basis of the test run. The results obtained under two of these contracts were as follows:

(a) Medium Tank (per unit):

Original price (middle of 1941).....	\$67,401
	Estimated redetermined value

Preliminary run (March 1942-December 1942), 1,000 units (including preproduction expenses).....	\$50,947
Test run (December 1942-February 1943), 1,000 units	39,079
Remainder (February 1943-August 1943); 1,053 units	39,285

(b) Light tank (per unit):

Original price (set during 1941).....	\$45,000
	Estimated redetermined value
Preliminary run (April 1942-October 1942), 1,000 units	\$34,625.99
Test run (October 1942-December 1942), 1,000 units	26,972.96
Remainder (December 1942-February 1943), 1,266 units	28,347.09
2nd Preliminary run (February 1943-June 1943), 1000 units	24,658.65

(c) The following table illustrates the sharp decrease in costs following a sharp rise in quantity of production, and the gaining of manufacturing experience. The figures represent revisions of General Motors Corporation's price for the .50 cal. heavy barrel machine gun:

	Units	Price
Original price (Aug. 1941-Dec. 1941).....	1,308	\$868.07
1st revision (Jan. 1942-Mar. 1942).....	2,830	632.55
2nd revision (Apr. 1942-May 1942).....	3,247	532.00
3rd revision (May 1942-Sept. 1942).....	14,717	413.60
10th revision (June 1943-Aug. 1943).....	3,500	300.59

17. Faced with these difficulties of estimating production costs and also with the pressing need for speed in procurement, the War Department naturally chose to emphasize, after December 7, 1941, the speedy placing of a mass of contracts. Pressure to obtain supplies was already great before the attack on Pearl Harbor, but thereafter it was made even clearer to contracting officers that they were expected to place the increasing load of orders assigned to them with the least possible delay. The war would not rest to allow proper negotiation, and the War Department made it clear that the primary

goal was speed in obtaining the necessary equipment and supplies. Illustrative is P. & C. General Directive No. 8,¹ issued January 14, 1942 (attached hereto as Exhibit B), which stated that "price is a secondary consideration as compared with speed and efficient production," and "speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. * * * War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field." War Production Board Directive No. 2, March 3, 1942, placed "primary emphasis * * * upon securing delivery in the time required by the war program." P. B. General Directive No. 34, dated April 9, 1942, which coordinated War Department rules concerning purchases, reiterated the WPB standards and added that in giving effect to these policies "it is recognized that it may be necessary to purchase at other than the lowest price offered."

18. To implement this policy of speedy procurement, and at the same time to adjust, as best it could, to the conditions of wartime production, the War Department adopted several procurement devices and policies.

¹P. & C. General Directives were issued, under my direction, by the Purchases and Contracts Branch of the Office of the Under Secretary of War; this branch later became the Contract Division, and the directives were entitled CD General Directives; in March 1942, the unit became the Purchases Branch, Procurement and Distribution Division, Headquarters, Services of Supply, and the directives were entitled PB General Directives.

(a) Peacetime War Department procurement, with certain exceptions, was accomplished through advertising for bids. At the beginning of the general emergency it was foreseen that this method would prove impracticable for emergency procurement, and the Act of July 2, 1940 (Public No. 703, 76th Congress) authorized contracting without advertising for national-defense purposes. This authority was widely used for the purchase of such supplies as aircraft and tanks, but in many fields it was believed that the Government could still avail itself of the safeguards of letting contracts by advertising. After the declaration of war, however, it was seen that negotiation would have to supplant advertising almost entirely. The increased need for speed in procurement, the necessity of employing even high-cost producers, the unfamiliarity of most contractors with the products or the quantities they were called upon to manufacture, and all the uncertainties of the period described above, combined to render advertising unsuitable to wartime procurement. Accordingly, on December 16, 1941, the Secretary of War issued a directive broadly extending the authority to make procurements without advertising, and by directive of December 17, 1941 (P. & C. General Directive No. 81) I ordered "that the authority to place orders without advertising be utilized in all cases where that method of procurement will expedite the accomplishment of the war effort." The First War Powers Act of 1941 (approved December 18, 1941), and Executive Order No. 9001, issued December 27, 1941, confirmed and

extended the power to make contracts by negotiation, and thereafter the use of that method became dominant in Army procurement. On March 3, 1942, War Production Board Directive No. 2 required all of our war contracts to be negotiated (unless specific authority to advertise were granted), and on March 4, 1942, this rule was made effective in the War Department by CD General Directive No. 25.

(b) Speed in procurement and the utilization of all available producing facilities required decentralization of procurement, increased subcontracting, and widespread distribution of war orders

(1) Prior to December, 1941, considerable decentralization had been effected; the limits of the dollar amounts of contracts which could be approved by echelons below the office of the Under Secretary of War had gradually been raised to \$500,000. On December 16, 1941, the Secretary of War directed a sweeping decentralization of procurement, and on the next day I issued P. & C. General Directive No. 81, empowering the chiefs of the supply arms and services to approve contracts up to \$5,000,000, and authorizing them to decentralize still further. This directive stated that "In order to enable orders to be placed in the quickest possible time, it is desired that chiefs of supply arms and services decentralize to their field agencies the actual work of procurement and the placing of awards and contracts to the greatest extent compatible with efficiency and proper safeguarding of the public interest."

(2) Subcontracting had also been fostered from the

beginning of the emergency, since it was foreseen that full defense production could not otherwise be achieved. With the outbreak of the war, P. & C. General Directive No. 8, dated January 14, 1942 (Subject: "Selection of Contractors for war production"), strongly emphasized this need and required procurement official to insist upon subcontracting: "The heavy procurement program and need for speed in production make vital the best utilization of every facility." (3) For the same reasons, the policy of the widespread distribution of defense orders was adopted. This policy was partially crystallized in War Production Board Directive No. 2, March 3, 1942, which stated "that contracts shall be placed so as to conserve, for the more difficult war-production problems, the facilities of concerns best able, by reason of engineering, managerial, and physical resources, to handle them. Accordingly, contracts for standard or other items which involve relatively simple production problems shall be placed with concerns, normally the smaller ones, which are less able to handle the more difficult war-production problems."

(c) Letters of Intent were used early in the emergency to expedite production. Through use of this form of contract, the contractor could begin manufacturing the needed supplies before agreement had been reached on a definite price, or the full extent of the procurement determined. The slightly different letter contract form was authorized in May and June, 1941, for the same purpose. On December 17, 1941, there was issued at my direction, P. & C.

General Directive No. 88, which ordered the more extensive use of letter contracts "in the interest of expediting procurement." On January 16, 1942, revised letter contract forms were issued, and on January 13, 1942, a letter purchase order (to replace the letter of intent) was issued and its use directed by contracting officers "where the necessity for the supplies is so urgent as to render prior negotiations in respect to price, schedule of deliveries, or other terms impracticable, or where negotiations in respect thereto have failed to result in an agreement" (P. & C. General Directive No. 5). These policies were emphasized to the contracting personnel by the various supply arms and services. For instance, the Signal Corps directed (April 20, 1942) that in no case in which time was of the essence should the selection of a satisfactory contractor be delayed to await agreement on the price; "if immediate agreement cannot be reached on the price, a letter purchase order or a letter of intent should be issued to the contractor selected, so that production can be initiated pending the negotiation of price." Pursuant to these directions, these contract forms were used in great number throughout the War Department.

19. Contractual devices were also adopted in an attempt to overcome the insistence of contractors on covering all the contingencies of wartime production into their prices.

(a) One means, of course, of eliminating the probability of excessive profits and of tying the contract price to actual costs is the cost-plus-fixed-fee

form of contract. The Act of July 2, 1940, authorized the use of this form, and War Department directives of the same day permitted its use when "deemed necessary in the interest of the United States in order to accomplish or expedite the national defense program." But this form of contract has never been favored by the War Department, for the reasons that it offers no financial incentive to control or reduce costs and that it requires an inordinate amount of auditing and paper work. However, its use was found necessary in some cases. P. & C. General Directive No. 81, dated December 17, 1941, provided that "contracts will be negotiated on a cost-plus-a-fixed-fee basis only when the use of that form of contract is essential." Later directives have continued and strengthened that policy and have consistently urged the conversion of cost-plus-fixed-fee contracts to the fixed-price basis.

(b) Another attempt to meet the objections of suppliers who felt that they could not quote firm prices because of anticipated rises in material and labor costs, were escalator—price adjustment clauses. On September 17, 1941, the War Department approved a price adjustment (escalator) article to be used "only in exceptional cases where the facts justify their use." (P. & C. General Directive No. 48). It was expressly required that all contracts containing the escalator clause also include an article providing for termination of the contract for the convenience of the Government. On December 17, 1941, P. & C. General Directive No. 86 issued certain amendments, mainly concerning indirect

labor and material costs, to the approved clauses. Copies of these two directives (including the escalator clauses) are attached hereto as Exhibits C and D. Escalator clauses present some of the undesirable features of cost-plus contracts. Their administration is complex, and they require extensive accounting and auditing.

These devices were not favored by the War Department, for the reasons I have stated. By themselves, they were not satisfactory or effective methods for confining profits to reasonable levels or for decreasing production costs. Other means of attaining these ends had to be developed.

Need for Renegotiation and Profit Limitation and Measures to That End

20. At the beginning of the limited emergency in 1939, the only applicable statutory limits on profits from the sale of military or naval supplies were contained in the Vinson-Trammel Act of March 27, 1934, as amended (relating to naval vessels) and the Merchant Marine Act of 1936, as amended (relating to construction of merchant ships). The Act of April 3, 1939, extended percentage profit limitation to cover Army aircraft contracts. The percentage of profit allowed to contractors was lowered to approximately 8% by the Act of June 28, 1940, but the Second Supplemental National Defense Appropriation Act, 1941, enacted September 9, 1940, provided that as to aircraft the old limitation of 12% was to prevail.

21. Manufacturers of war products, particularly

aircraft manufacturers, asserted that they could not take Government contracts in the face of these profit limitations. Many subcontractors were reluctant to work for them under Government prime contracts at 8% or 12% when they could make 15% or 20% working for civilian manufacturers. Moreover, many subcontractors were unwilling to take contracts which involved the necessity of keeping elaborate cost records subject to Government audit. It was therefore decided that the Vinson Act would have to be suspended, and that an excess profits tax should be levied. Accordingly, the Second Revenue Act of 1940, containing the excess profits tax, suspended the profit limitation statutes applicable to Army and Navy contracts entered into after December 31, 1939, or uncompleted on that date by contractors and subcontractors subject to the new excess profits tax. Thereafter, until the passage of the Sixth Supplemental National Defense Appropriation Act of 1942, the only statutory provisions concerning war or defense contracts were those of the excess profits tax.

22. From the beginning of 1942, officials of the War Department were aware that a necessary result of the unstable purchasing conditions of war procurement would be the accumulation by many contractors and subcontractors of excessive profits which would not be siphoned off by the existing tax legislation. Publication of financial reports of war contractors for 1941 indicated the tremendously increased profits derived from the more limited defense program. The decision of the Supreme Court

in *United States v. Bethlehem Steel Corporation*, 315 U. S. 289, decided in February 1942, reemphasized the extent of the profits which had been made in World War I. On March 23, 1942, the Naval Affairs Committee of the House of Representatives conducted a hearing on the defense profits of Jack & Heintz, Inc. (Hearings before the Committee on Naval Affairs, House of Representatives, 77th Cong., 2d Session, pursuant to H. Res. 162, Vol. 1), and the information divulged at that hearing on the exorbitant profits made by that concern received wide publicity. Other information of the same character was developed by the Naval Affairs and other Congressional Committees and was made available to the War Department. The War Department and at least one of the supply services (the Signal Corps) established rudimentary cost analysis units to study the manufacturing cost, of Army suppliers, and preparations were made to review and check contract prices.

23. The need for eliminating excessive profits obtained from war production is as paramount as it is obvious. Excessive profits mean increased tax and war loan burdens on the public and increased pressure toward inflation. Undue profit margins are also a cushion for wasteful and costly manufacture. Perhaps most important is the destructive effect of excessive war profits upon the morale of men in the armed services and of civilian workers. The sharp reaction to war profits which occurred after World War I is eloquent testimony of the significance of this factor.

Voluntary Renegotiation

24. During the defense period, prior to December 7, 1941, there had been a certain number of voluntary refunds and price reductions by defense contractors. In June and July, 1941, War Supplies, Ltd., the Canadian Government corporation through which the United States purchases in Canada, agreed to refund to the War Department all profits over 10% of cost. In October 1941, it was found advisable to issue a directive on the taxable character of sums received by contractors but voluntarily refunded to the United States. P. & C. General Directive No. 54, October 7, 1941, stated that: "From time to time a contractor with the Government discovers that his profits are larger than he had at first estimated, and desires to refund the excess to the United States. Under these circumstances, certain contractors have hesitated lest in making the refund they subject themselves to a tax penalty, either through paying or having paid income taxes on the profits received or through being forced to pay a gift tax on any refund." But voluntary renegotiation took on much greater scope in early 1942.

25. On the same day that they appeared before the Naval Affairs Committee (March 23, 1942) officials of Jack & Heintz, Inc. met with procurement officials of the War Department for the purpose of reviewing the Company's Army contracts. It was agreed that the contractor would reduce its prices on its various contracts, totaling somewhat over

\$50,000,000, by an over-all amount slightly in excess of \$10,000,000. On March 28, 1942, our procurement officials met with officials of Continental Motors Corporation to review that company's aircraft contracts. After negotiations, the company voluntarily agreed to reduce its prices on existing contracts by a total of \$40,000,000. A third such meeting, on April 6th, with the Sperry Corporation resulted in a voluntary reduction of about \$100,000,000.

26. Other voluntary renegotiations were effected in the first quarter of 1942. A number of contractors expressed their willingness to adjust their prices to reflect actual costs, as they developed, and to restrict their profits to proper wartime levels.

(a) Prior to May, 1942, General Motors Corporation had made voluntary price reductions running into more than \$200,000,000, according to its own figures. One example follows: In a contract made in August 1941 for 8,000 aircraft engines, the Allison Division of General Motors included contingency reserves in the unit prices but stated that if excessive profits developed during the course of performance it would be willing to grant reductions on undelivered engines. In December 1941 and January 1942, the War Department received information that costs were lower than anticipated. Renegotiation discussions were begun with the contractor, and on March 30, 1942, it offered to refund approximately \$20,000,000 to the Government.

(b) In June 1941, Republic Aviation Corporation undertook to manufacture 125 P-43A airplanes,

over a period of some ten months, at a stated unit price. The Government's negotiators believed that the agreed price might lead to excessive profits. The contractor's representatives, though believing that the price was not too high, orally agreed that if profits in excess of 10 or 11 per cent were made, the company would either voluntarily reduce its contract price or would construct an experimental plane for the Government without cost. On December 10, 1941, the contractor informed the Government that its profit on the contract would probably exceed the stipulated amount and suggested that it furnish the experimental airplane. The War Department was not interested in the experimental airplane, and after further cost figures indicating excessive profits became available, the contractor offered an acceptable voluntary price reduction of \$1,445,370.00.

(c) In April 1942, information became available that Beech Aircraft Corporation was making a profit of approximately 33% on its airplane contracts. On April 16th and 17th the Company agreed to review the contract prices, and shortly thereafter price reduction agreements were consummated.

(d) Similarly, in April 1942 discussions were begun with Cessna Aircraft Corporation, Bendix Aviation Corporation, and some other contractors, which resulted in price reductions.

27. In March 1942, the War Department determined to establish formal price renegotiation machinery, and plans were drawn for a Price Adjustment Board to negotiate with contractors for reduced prices where excessive profits had been or

were likely to be secured. On March 27, 1942, there was prepared in the War Department a tentative memorandum outlining the policy and procedure of the putative War Department Price Adjustment Board. The purpose of the Board, its operating policies, and method of operations were set forth, as well as a list of factors to be considered in determining the reasonableness of profits. A copy of this memorandum is attached as Exhibit E. To be noted is the similarity between the factors listed as governing profit reasonableness in this memorandum, in the Joint Statement by the War, Navy, and Treasury Departments and the Maritime Commission, dated March 1943, and in the Renegotiation Act, as amended and reenacted in the Revenue Act of 1943. This memorandum of March 27th was not published nor was it issued officially, but use was made of it in voluntary renegotiations conducted by the War Department. At the meeting of March 28th with Continental Motors Corporation (see paragraph 25 above) this memorandum was read to the contractor's representatives as a preliminary and tentative statement of War Department policy on excessive profits.

28. Title XIII of the Second War Powers Act, enacted March 27, 1942, conferred upon the Government authority to inspect the plants, books, and records of war contractors. On April 10th, the President issued Executive Order 9127 ("Designating the Departments and Agencies to Inspect the Plants and Audit the Books and Records of Defense Contractors under Title XIII of the Second War

Powers Act, 1942'') in order "to prevent the accumulation of unreasonable profits, to avoid waste of Government funds, and to implement other measures which have been undertaken to forestall price rises and inflation." Under this order, the cost analysis units in the War Department were expanded and strengthened, and a new basis was laid for price adjustment boards.

29. The Under Secretary of War, the Under Secretary of the Navy and the Chairman of the Maritime Commission (with the approval of the Chairman of the War Production Board) agreed to establish price adjustment boards within the three agencies in order to advise and assist procurement officials "in securing adjustments or refunds in instances where it is determined that costs or profits of contractors are, or may be, excessive for any reason." A copy of this memorandum is attached as Exhibit F. Plans for such a board in the War Department had been proceeding meanwhile and on April 25th, Lieutenant General Brehon Somervell, Commanding General of the Services of Supply, formally established such a price adjustment board, with my approval. A copy of his memorandum is attached as Exhibit G.

30. A corollary to the establishment of these procedures for voluntary renegotiation, without specific contractual or statutory basis, was the development of contract clauses looking toward the renegotiation or redetermination of prices after partial or complete performance. The problem was submitted to

a committee of representatives of the War Production Board, the War Department and the Navy Department and resulted in the preparation of two contract clauses. One, known as the "redetermination clause," was designed to permit automatic adjustment downward in price on the basis of actual cost experience during a "test run" early in the performance of the contract. The other contract provision, originally known as the "renegotiation clause," was designed to permit adjustment of the price either upward or downward in the light of actual cost experience after part performance, as soon as reasonable reliable cost estimates were feasible. These articles were promulgated for use in War Department contracts by P. B. General Directive No. 31 dated March 13, 1942, a copy of which is attached as Exhibit H. One of the purposes of the new clauses can be gained from the opening statement of the directive that "It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts."

Statutory Proposals

31. The Congress was, of course, also concerned with the probability that excessive profits would be made by many war contractors, despite the excess profits tax. The disclosures at committee hearings and the profit information available was thought to require legislative action. In March 1942, a bill was introduced to establish a rigid profit limitation of 6% on war contracts. On behalf of the War De-

partment, I opposed this proposal before the Committee on Naval Affairs of the House of Representatives (March 19, 1942), and Mr. Donald Nelson opposed it on behalf of the War Production Board (March 24, 1942). (Hearings before the Committee on Naval Affairs, House of Representatives, 77th Cong., 2d Session, on H. R. 6790, pp. 2473-2475, 2577-2578.) Mr. Nelson and I pointed out that the bill, if enacted, was likely to interfere with war production, especially by delaying the conversion of small business to war work and also by forcing the increased use of the cumbersome and wasteful cost-plus-fixed-fee contract. We also pointed out that a fair percentage of profit was not solely a function of the cost of performance but depended upon such factors as turn-over, volume of business, amount of invested capital, financial structure, time of performance, and contribution to increased efficiency. Depending upon these factors, and particularly upon dollar volume of business, a 6% profit might be far too large or far too small. Attention was also called to the impossibility, under the flat percentage system, of allowing the recoupment of losses. At the same time, I stressed to the Committee that the War Department recognized its "plain duty to take every practicable step to prevent contractors from obtaining excessive and unconscionable profits," and I described the cost analysis and price adjustment projects which were then being formulated (see pars. 27-29 above), and the price redetermination and revision clauses which had been authorized (see par. 30 above). This profit limitation

bill, to which I expressed the War Department's opposition, was not acted upon by the House of Representatives.

32. On March 28, 1942, Congressman Case offered on the floor of the House of Representatives two profit-limitation amendments to the Sixth Supplemental National Defense Appropriation Bill. His first proposal was that no final payment on a war contract be made by the Government "until the contractor shall have filed with the procuring agency a certificate of costs and an agreement for renegotiation and reimbursement satisfactory to the Secretary of War or the Secretary of the Navy, as the case may be." This amendment was subject to a point of order, and Congressman Case then offered a substitute amendment providing that final payment was not to be made "to any contractor who fails to file with the procuring agency a certificate of cost and an agreement for renegotiation of contract and reimbursement of profits in excess of 6 per cent." This amendment was adopted by the House of Representatives without debate. Mr. Case has stated that his proposals were modeled, in part, upon the renegotiation clauses developed by the procurement agencies (see par. 30 above). See Hearings before the Subcommittee of the Committee on Appropriations, U. S. Senate, 77th Cong., 2nd Sess. on H. R. 6868, pp. 89-92, 211-2.

33. At a hearing held on March 31 and April 1, 1942, by a subcommittee of the Senate Committee on Appropriations, on the Sixth Supplemental National Defense Appropriations Bill for 1942, represent-

atives of the Government stated the objections to the Case amendment, as it then stood. General Somervell reviewed the factors making adequate pricing impossible in many cases and described the price adjustment procedures which had already been established in the War Department. The committee was informed that a Cost Analysis Section and a Price Adjustment Board had been set up and were at work and tentative policies and procedures had been laid down (Hearings pp. 24-25). The approved "redetermination" and "renegotiation" contract articles were also described to this subcommittee and their use explained. General Somervell, Mr. Donald Nelson of the War Production Board, and other representatives of the procurement agencies again stated the objections to an inelastic profit-limitation provision of the type of the Case amendment. It was pointed out that the amount and rate of profit should depend—out of fairness to contractors and to furnish the proper incentive to reduce costs—on a number of factors such as rapidity of turn-over, development costs, production time, money invested in the business, risks incurred, efficiency of production; a flat percentage limitation lumping all contractors together would not only be unfair to many and too generous to others but is subject to the very defects which have placed the cost-plus contract in disfavor; moreover, the statutory percentage of profit which is intended to be a maximum tends to become a minimum and contractors believe that they are entitled to receive that rate of profit.

34. The Senate Subcommittee requested the procurement agencies to supply a substitute for the Case amendment. On April 2, 1942, General Somervell submitted a proposal on behalf of the War and Navy Departments and the War Production Board. A copy of this substitute proposal is attached as Exhibit I. The suggestion was based on the theory that if every contract price could be reexamined by the parties in the light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits. Section 403, as finally enacted, differs in many respects from our proposal, but it retains the central principle that a fixed percentage limitation on profits should not be established.

35. The War Department has consistently opposed the substitution of a 100% excess profits tax in place of the renegotiation statute, for the same reasons for which we disapproved a flat percentage limitation on profits from war contracts. Our views are stated at length in the report of the Hearings before a Subcommittee of the Senate Committee on Finance on Section 403 of Public Law No. 528, September 29-30, 1942, 77th Congress, 2d Session, and the Hearings before the Committee on Naval Affairs, House of Representatives, pursuant to H. Res. 30, June 1943, 78th Cong., 1st Sess. pp. 997-1000. The Introductions to the Renegotiation Regulations of the War Contracts Price Adjustment Board and to the Joint Renegotiation Manual approved by the Joint Price Adjustment Board also contain statements on this point with which the War Department

is in accord. In brief, the major objection to a 100% excess profits tax is that it would remove all incentive to reduce costs or promote efficiency, and in this respect would tend to increase the cost of war procurement through the waste of manpower and resources so as to counterbalance any gain in tax collections.

36. The War Department has found that the Renegotiation Act is the most satisfactory and effective method of eliminating excess profits on war contracts. The Department has vigorously opposed the repeal of the statute.

Contracts on Which Final Payment Had Not Been Made on April 28, 1942

37. At the end of April 1942, the following amounts were obligated for contracts, but unexpended, by the Navy Department and the three major procurement services of the War Department:

Army Air Forces contracts, over.....	\$16,700,000,000
Ordnance Department contracts, over	10,000,000,000
Engineers contracts, over	4,000,000,000
Navy contracts, over	18,000,000,000
<hr/>	
Total, over.....	\$48,700,000,000

These figures concern only the agencies listed; they do not include subcontracts; nor do they include sums actually paid prior to April 28, 1942, on contracts on which final payment was not made until after that date. The figures do, however, include sums owing on some contracts exempt from renego-

tiation under the statute, but such sums are relatively small.

38. On the whole, it is certain that, on April 28, 1942, there were outstanding uncompleted war contracts in a total figure considerably in excess of 50 billion dollars which would have been exempt from renegotiation if the statute had not been made applicable to contracts existing on April 28th but with respect to which final payment had not been made by that date.

39. It is impossible to give more than the most general data concerning the life of the uncompleted contracts in existence on April 28, 1942. The average time required for the construction of the major types of projects (cantonments, airfields, ordnance plants) being constructed under the supervision of the Corps of Engineers in April 1942 was from 7 to 18 months. A substantial proportion of the Ordnance contracts placed during the first four months of 1942 extended for over six months; some of these contracts contemplated production extending over a period as long as two years. The Navy Department estimates that at least one-third of its funds which were obligated but unexpended on April 30, 1942, represented contracts requiring 12 months or longer for performance.

Excessive Profits Eliminated by Renegotiation

40. As of September 19, 1944, 34,966 contractors had been assigned for renegotiation with respect to fiscal years ending during the calendar year 1942. As of the same date, 35,200 contractors had been

assigned for such renegotiation with respect to fiscal years ending during the calendar year 1943. Of the cases assigned with respect to fiscal years ending in the calendar year 1942, relatively few remain uncompleted; and the renegotiation agencies are well along toward completion of the cases assigned with respect to fiscal years ending in the calendar year 1943.

41. As of September 22, 1944, in 7,949 cases excessive profits had been determined by agreement between the contractor and the Government, and at that date in 207 cases excessive profits had been determined by unilateral action by the Government without the agreement of the contractor. Thus, 97.5% of the cases in which excessive profits had been determined involved bilateral agreements in which the contractor joined. These figures do not include the cases, of which there are a large number, in which no excessive profits were found or in which the renegotiation proceedings were cancelled as the result of information indicating no excessive profits. It should be noted, too, that the number of contractors affected by the bilateral agreements exceeds the number of 7,949, since many of these agreements affect groups of parent and subsidiary corporations.

42. It is impossible at the present time to give complete figures as to the dollar volume of the sales covered by the cases in which excessive profits have been determined. As of September 16, 1944, in the 7,733 cases concluded by bilateral agreement or unilateral determination (excluding Army construction contracts), the aggregate renegotiable sales of the

contractors affected (prior to adjustment for excessive profits eliminated) were \$30,975,405,000. Excessive profits eliminated in these cases amounted to \$3,586,652,000. In addition, approximately \$57,000,000 in excessive profits had been recovered from construction contractors assigned to the Chief of Engineers for renegotiation. These figures do not take account of reductions in Federal taxes occasioned by the elimination of excessive profits through renegotiation.

43. The figures in the preceding paragraph do not include excessive profits eliminated (a) by refunds made to contracting officers prior to and unrelated to statutory renegotiation, (b) by reduced prices with respect to future performance or deliveries under existing contracts, or (c) by reduced prices under new contracts. No statistical data are available as to the amounts of excessive profits so eliminated or prevented, but they have been substantial, and run into many hundred millions of dollars.

44. The data contained in paragraphs 40 to 43 cover renegotiations carried on by all agencies and not merely those in which the War Department is interested.

Renegotiation Procedure

45. From the very beginning of statutory renegotiation by the War Department, the attempt has always been made to secure the full cooperation of the contractor in the process of renegotiation. It has been the uniform practice to explain the purposes, policies and methods of renegotiation to con-

tractors and to elicit their participation both in the furnishing of information and in the drawing up of an agreement as to excessive profits. Although Title XIII of the Second War Powers Act, 1942, grants the Government certain powers to secure the pertinent records and data, on which renegotiation must be based, from recalcitrant contractors, we have always sought to obtain this information voluntarily, and without unduly hampering the contractor's activities. Similarly although the statute empowers the renegotiation agencies to determine excessive profits unilaterally, it has always been our policy to renegotiate, in the literal sense, and to seek a bilateral agreement with the contractor, whenever possible.

46. In most cases, renegotiation in the War Department (for fiscal years ending on or prior to June 30, 1943) was conducted initially by price adjustment sections of the supply services (e. g. Ordnance Department, Signal Corps, Chemical Warfare Service) and the Army Air Forces. If in the initial renegotiation the price adjustment section handling the cases reached an understanding with the contractor, a bilateral agreement was executed, both by the Government and by the contractor. If, however, the initial renegotiation proceedings did not result in an agreement with the contractor and an impasse was reached, the case was always referred to the War Department Price Adjustment Board. That Board, in the handling of impasse cases, was empowered to hold further meetings or discussions with the contractor. I am advised that

the War Department Price Adjustment Board, in every case in which a contractor requested a meeting with representatives of that Board, accorded the contractor the opportunity of such a meeting. If an agreement could not be reached between the representatives of the Board and the contractor in a case in which it was believed that excessive profits had been realized, the case was then referred, together with a full report, to me as Under Secretary of War. It has been my practice to refer such cases, for initial review, to one of my principal assistants, not otherwise connected with renegotiation. This assistant has invariably allowed the contractor, upon the latter's request, to meet with him before he made any recommendation that a determination of excessive profits should be made by me; and in this meeting the contractor could present any pertinent material not previously furnished and discuss the matter from the contractor's point of view. I have personally made the final determination that excessive profits have been made, and the amount of such excess, in every case in which a unilateral determination has been issued. In sum, opportunity is always afforded the contractor for discussions with representatives of the renegotiating agency and the presentation of pertinent data and argument. No unilateral determination has ever been made without the contractor's having been offered the opportunity, at some stage and in substantially all cases in several stages in the renegotiation process, to present his views and discuss the matter.

ROBERT P. PATTERSON.

Sworn to and subscribed before me this 16th day of December, 1944.

[Seal]

ANNA C. LANIGAN

Notary Public, D. C.

My Commission Expires June 15, 1946.

EXHIBIT A

W. P. B. Record of Monthly Awards of Prime War Supply Contracts

Date	Number of Contracts				
	Total	Aircraft	Ships	Ordnance	All Others
1941					
July	1,124	40	40	202	842
August	1,352	62	77	264	949
September	1,476	78	68	223	1,107
October	1,824	97	49	305	1,373
November	1,566	94	67	321	1,084
December	1,885	116	63	384	1,322
1942					
January	3,612	132	156	836	2,488
February	3,656	136	165	710	2,645
March	4,188	162	161	765	3,100
April	4,866	187	197	795	3,687
May	3,597	114	126	459	2,898
June	3,657	143	171	439	2,904

Date	Total	Value (Millions of Dollars)			
		Aircraft	Ships	Ordnance	All Others
1941					
July	1,057	92	129	551	285
August	1,842	688	237	636	281
September	1,335	386	159	436	353
October	2,404	1,264	107	569	464
November	1,506	261	288	461	495
December	3,131	985	406	1,150	589
1942					
January	9,456	2,435	2,092	4,015	914
February	7,301	3,628	893	1,891	889
March	5,343	1,440	728	1,842	1,333
April	5,715	1,234	1,014	1,808	1,659
May	4,843	1,337	759	1,530	1,216
June	5,299	937	1,249	1,709	1,404

EXHIBIT B

War Department
Office of the Under Secretary
Washington, D. C.

January 14, 1942.

PC-E-400.13 (Procurement).

P. & C. General Directive No. 8.

Memorandum for:

The Chief of the Air Corps.
The Chief, Chemical Warfare Service.
The Chief of Coast Artillery.
The Chief of Engineers.
The Chief, National Guard Bureau.
The Chief of Ordnance.
The Quartermaster General.
The Chief Signal Officer.
The Surgeon General.

Subject: Selection of contractors for war production.

1. The heavy procurement program and need for speed in production make vital the best utilization of every facility. As a limited number of facilities are able to undertake precision work, care must be exercised in allocating only such work to them, each plant to undertake the highest caliber of work its equipment can produce.

2. In awarding prime contracts, great weight must be placed upon the contractor's agreement to subcontract a high percentage wherever this is feasi-

ble. Unless secondary facilities are thus put to work on the simpler components, difficulty will later be encountered in placing prime contracts calling for precision work. The best results will be obtained by insisting upon such subcontracting at the time of the award of the prime contract as efforts to have prime contractors subcontract simpler components at a later date may be only partially successful after work has been started.

3. In many cases requirement of subcontracting will add to the total cost. Price is a secondary consideration as compared with speed and efficient production. Reasonable increase in price which will speed the program through subcontracting is justified. Because of the increase in price, subcontracting should be taken into account in making the award and should be provided for in the prime contract, where possible, rather than to assume that it can be arranged after the award has been made.

4. Speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. Accordingly, under our present decentralized procurement policy the chiefs of the supply arms and services and their district procurement offices must exercise their best judgment in the matters mentioned in paragraphs 1, 2 and 3 above. War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field.

By direction of the Under Secretary of War:

(s) JOHN W. N. SCHULZ,
Brigadier General, U. S. Army,
Director of Purchases and Con-
tracts. [91]

EXHIBIT C

War Department
Office of the Under Secretary
Washington, D. C.

September 17, 1941.

PC-L 162 (Escalator Clause).

P. & C. General Directive No. 48.

Memorandum for

The Chief of the Air Corps.

The Chief, Chemical Warfare Service.

The Chief of Coast Artillery.

The Chief of Engineers.

The Chief, National Guard Bureau.

The Chief of Ordnance.

The Quartermaster General.

The Chief Signal Officer.

The Surgeon General.

Subject: Price Adjustment Clause

1. Price Adjustment articles (escalator clauses) will be included in supply contracts only in exceptional cases where the facts justify their use. In determining the justification for the inclusion of

such a clause, the following factors, among others, should be given consideration:

(a) The inclusion of an escalator clause should result in a lower contract price than if such a clause were not included. Before consenting to the inclusion of an escalator clause in a contract, the contracting officer should satisfy himself that the contractor has not included in the contract price any amount to cover probable increased direct labor or direct materials costs.

(b) The time required for the performance of the contract should be such as to make it impossible [92] to forecast with reasonable accuracy the extent of changes in the direct labor or direct materials cost under the contract. Ordinarily the time of performance should not be less than six (6) months.

(c) The contract should be of sufficient amount to warrant the administrative expenses which would be incurred in administering the escalator clause. As a general rule, contracts for less than \$100,000 would not warrant such expenditure.

2. Attached hereto are copies of the Price Adjustment article (escalator clause) as approved by the Under Secretary of War on September 13, 1941, for use in supply contracts hereafter entered into where it has been determined that an escalator clause should be included. Any deviations from this form will be made only after approval in each case by the Under Secretary of War. Requests for such approval will be accompanied by a detailed

statement of the facts and reasons justifying such deviation.

3. All contracts containing this escalator clause will also contain an article providing for termination of the contract for the convenience of the Government.

4. It is desired that the foregoing instructions be communicated promptly to all contracting agencies in your branch.

By direction of the Under Secretary of War:

(s) JOHN W. N. SCHULZ,

Brigadier General, U. S. Army,
Director of Purchases and Con-
tracts.

Incls.

cys. Price Adjustment Clause. [93]

**FORM OF ESCALATOR CLAUSE APPROVED
BY THE UNDER SECRETARY OF WAR,
SEPTEMBER 13, 1941**

Article..... Price Adjustments.

The total contract price stated in Article.....
is subject to adjustment for increases or decreases
in direct labor and direct material costs in accord-
ance with the following method:

(a) Labor.

(1) Upon the basis of labor costs prevailing in
....., 194.. (hereinafter called the base
month) the direct labor cost is estimated to be
\$..... Direct labor, as used herein,

refers only to the labor of employees of the Contractor performed directly on, and properly chargeable to, the supplies manufactured hereunder, excluding but without limitation, all executive, managerial, supervisory, technical, professional, office, clerical and sales employees, but including working foremen, gang-bosses and strawbosses. The Contractor represents that the above estimated cost is based upon a schedule, approved by the Contracting Officer, of the kinds or classes of jobs or occupations to be charged as direct labor under this contract, and that the estimate includes only such jobs or occupations. In computing the actual direct labor cost for the purposes of paragraph (a) (2) and (a) (3) hereof, the cost of kinds or classes of jobs or occupations not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the estimated direct labor cost set forth above shall be apportioned into direct labor cost quotas for the consecutive three-month periods (hereinafter called "quota periods") beginning on the first [94] day of, 194.,¹ and on the first day of each third month thereafter. This apportionment shall be made by dividing the actual direct labor cost properly charged to this contract during each quota period by the total

¹The month during which the contract is executed or performance is commenced, whichever is earlier.

actual direct labor cost under the contract, and by multiplying the percentage thus obtained for each quota period by the total estimated direct labor cost. The result shall be the direct labor cost quota for that period.

(3) Upon the basis of the average hourly earnings in the durable goods manufacturing industries compiled by the United States Department of Labor, Bureau of Labor Statistics, the Government will determine the average hourly earning for each quota period by adding the average hourly earnings for each month of such quota period and dividing their sum by three, and calculations will be made of the percentage of change of such average hourly earnings for each quota period in comparison with the average hourly earnings for the base month. The labor cost quota for each quota period will then be multiplied by the percentage of change for such quota period, and the result will be applied as an increase or decrease in the contract price; Provided, That the total of such increases in the contract price shall not exceed the amount by which the total actual direct labor cost exceeds the total estimated direct labor cost, and that the total of such decreases in the contract price shall not exceed the amount by which the total actual direct labor cost is less than the total estimated direct labor cost.

(b) Materials. [95]

(1) Upon the basis of materials costs prevailing in the base month, the cost of direct materials

which the Contractor will purchase for the performance of this contract, excluding materials to be used which the Contractor has on hand or for which firm price commitments have been obtained by him (hereinafter call "direct materials to be purchased hereunder"), is estimated to be \$..... (hereinafter called "estimated adjustable materials cost"). Direct materials as used herein refers only to those materials which go into and become a component part of the Contractor's finished product and which, under the cost accounting system regularly employed in the Contractor's plant, are accounted for by direct charges to the particular contract. The Contractor represents that the above estimate is based upon a schedule, approved by the Contracting Officer, of the kinds and classes of "direct materials to be purchased hereunder." In computing the actual cost of "direct materials to be purchased hereunder" for the purposes of paragraphs (b) (2) and (b) (3) hereof, the cost of kinds or classes of materials not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the "estimated adjustable materials cost" shall be apportioned into materials cost quotas for the quota periods as defined in paragraph (a) (2) above. This apportionment shall be made by dividing the total actual cost of "direct materials to be purchased hereunder" into the portion of such cost properly charged to the contract

during each quota period, and by multiplying the percentage thus obtained for each quota period, by the total "estimated adjustable materials cost." The result shall be the materials cost quota for that period. Direct materials shall be [96] charged to the contract for the quota period during which the price therefor is determined as between the Contractor and the materials supplier; Provided, That where commitments are obtained by the Contractor for future deliveries at a firm price in excess of the market price prevailing at the time such commitments were obtained, such materials shall be charged to the contract for the quota period during which delivery is to be received by the Contractor; And, Provided further, That with respect to materials which are not identifiable with the purchase commitments under which they are acquired, determinations as to (1) whether the materials employed in the performance of this contract were on hand at the time the contract was executed, and (2) the quota period to which the materials are to be charged and the amount of such charge shall, with the approval of the Contracting Officer, be made on the basis of the accounting system regularly employed in the Contractor's plant.

(3) The Government will average for each quota period the index numbers of wholesale prices for² compiled by the United States

²The index for the commodities group which includes the items making up the major portion of the "direct materials to be purchased hereunder."

Department of Labor, Bureau of Labor Statistics for the three months included within such quota period, and calculations will be made of the percentage of change of such average index numbers for each quota period in comparison with the index numbers for the base month. The materials cost quota for each quota period shall then be multiplied by the percentage of change for such quota period, and the result will be applied as an increase or decrease in the contract price; Provided, That the total of such increases in [97] the contract price shall not exceed the amount by which the actual cost of "direct materials to be purchased hereunder" exceeds the total "estimated adjustable materials cost," and that the total of such decreases in the contract price shall not exceed the amount by which said total actual cost of "direct materials to be purchased hereunder" is less than the total "estimated adjustable materials cost."

(c) General.

(1) For the purpose of determining increases or decreases in contract prices, rates of change in average hourly earnings and rates of change in the materials index number will be calculated to the nearest one-tenth of one per cent, and there shall be used the latest figures which shall have been issued by the Bureau of Labor Statistics up to the close of the fourth month following the last quota period under this contract.

(2) Payments for increases, or deductions for decreases in the contract price, resulting from the operation of this article, will be made after the

completion of the calculations of price adjustments in accordance herewith; Provided, That the Government may, from time to time during the life of the contract, make partial payments on account of such increases, subject to such requirements as a condition precedent to such payments as the Contracting Officer may provide; Provided, further, That in this event such partial payments shall exceed the amount due to the Contractor by the operation of this article, the Government shall deduct the amount of such excess from any further payments due under this contract.

(3) Should the Contractor, during the performance of this contract, on account of subcontracting, or otherwise, depart from the production methods upon which the estimates and schedules of direct labor and direct [98] materials costs were based to such an extent that the use of such estimates or schedules will operate to produce an unfair adjustment of the contract price, a corresponding correction in such estimates or schedules may be made by mutual agreement between the Contractor and the Contracting Officer. In the event of disagreement with respect to the need for or extent of such correction, the procedure of Article 12 (Disputes) shall apply.

(4) If this contract is terminated pursuant to any provision thereof the contract price shall be adjusted as provided above, except that for the purposes of paragraphs (a) (2), (a) (3), (b) (2), and (b) (3), the terms "estimated direct labor

cost" and "estimated adjustable materials cost" shall be understood to refer to that part of such costs which corresponds to that proportion of the supplies contracted for which is completed and delivered by the Contractor, and the terms "actual direct labor cost" and "actual cost of direct materials to be purchased hereunder," shall refer only to that part of such costs which is properly chargeable to the supplies completed and delivered.

(5) The Contractor shall file with the Contracting Officer, not later than sixty days after the completion of the performance of the work under this contract or after its termination, a statement of the actual direct labor costs and the actual costs of "direct materials to be purchased hereunder," certified as correct by an independent public accountant approved by the Contracting Officer, showing the amounts of such costs properly chargeable during each quota period and, in case of termination, the amounts properly chargeable to the supplies completed and delivered. In determining the total actual direct labor cost and the total [99] actual "direct materials to be purchased hereunder," and in determining the amounts thereof to be charged in each quota period, the Contractor may, subject to the approval of the Contracting Officer and to the limitations of paragraph (b) (2), employ the accounting system regularly employed in the Contractor's plant. Such statement shall be deemed prima facie correct. The Government reserves the right to audit the books and records of

the Contractor, to determine the accuracy of such determinations and certification, and to obtain any information in connection with the operation of this Article. All information obtained from the Contractor's records shall be treated as confidential. The Contractor shall preserve all the books, papers, and other accounting records pertaining thereto; Provided, that if the Contractor at any time after the lapse of three years following the completion or cessation of work under the contract, desires to dispose of said books, papers, and accounting records, he shall so notify the Secretary of War, or his duly authorized representative, who shall either authorize their destruction or notify the Contractor to turn them over to the Government for disposition. [100]

EXHIBIT D

War Department
Office of the Under Secretary
Washington, D. C.

PC-L 162.

December 17, 1941.

P. & C. General Directive No. 86.

Memorandum for:

The Chief of the Air Corps.

The Chief, Chemical Warfare Service.

The Chief of Coast Artillery.

The Chief of Engineers.

The Chief, National Guard Bureau.

The Chief of Ordnance.

The Quartermaster General.

The Chief Signal Officer.

The Surgeon General.

Copy to:

The Judge Advocate General—for information.

Subject: Amendment to Price Adjustment Clause.

1. Reference is made to the form of escalator clause approved by the Under Secretary of War on September 13, 1941, accompanying P. & C. General Directive No. 48.

2. It has been determined that the escalator clause should be amended so as to provide for adjustments on account of changes in pay-roll taxes, and therefore, the approved form of escalator clause will be amended by adding the following provision thereto as paragraph (c) (6):

“If after the date on which the prices herein were quoted, the Congress or any state legislature, shall impose, remove, increase or decrease any pay-roll tax required to be borne by the [101] contractor and directly applicable to or measured by the pay-rolls of the contractor hereunder, then the rate of such newly imposed tax, or the net increase or net decrease in the rate of a previously imposed tax, shall be multiplied by that portion of the actual direct labor cost which is subject to such increases or decreases in the tax or taxes, and the result shall be paid the contractor under this paragraph.”

3. It has also been determined that the escalator clause should be amended so as to provide for adjustment on account of changes in indirect labor

and indirect material costs. Accordingly, the following amendments to the approved form of escalator clause will be made:

(a) As a second sentence to Paragraph (a) (1), add the following:

“It is also estimated that the indirect labor cost attributable to this contract is.....% of such estimated direct labor cost.”

(b) Add the following as Paragraph (a) (4):

“The total increase or decrease to be paid or deducted under Paragraph (a) (3) shall be multiplied by.....%¹ and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect labor cost under this contract.”

(c) Add the following as the second sentence in Paragraph (b) (1):

“It is also estimated that the indirect materials cost attributable to this contract is.....% of such estimated direct materials cost.”

(d) Add the following as Paragraph (b) (4):

“The total increase or decrease to be paid or deducted under Paragraph (b) (3) shall be [102] multiplied by.....%² and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect materials cost under this contract.”

¹The percentage of indirect labor cost stated in Paragraph (a) (1).

²The percentage of indirect materials cost stated in Paragraph (b) (1).

4. In negotiating the estimated direct labor cost, the percentage thereof represented by indirect labor cost, the estimated direct material cost, and the percentage thereof represented by indirect material cost, the Contracting Officer should consider, among other things, the following factors:

(a) The amount of the estimated direct labor cost and the amount of the estimated direct materials cost should be limited in accordance with the definitions of direct labor and direct material costs contained in paragraphs (a) (1) and (b) (1) of the escalator clause, and should not include any amounts for indirect labor or indirect material costs;

(b) The total of the estimated direct labor cost and the estimated direct material cost, together with the amounts obtained by the application of the percentages set forth for indirect labor and indirect materials, should bear a reasonable relation to the total contract price. In any case where the difference between the total of these amounts and the contract price does not leave a reasonable margin to cover profit, rent, depreciation, taxes, and similar costs not included in the labor or material costs factors, it will be apparent that the estimates are too high, and should be accordingly reduced.

By direction of the Under Secretary of War:

(s) JOHN W. N. SCHULZ,
Brigadier General, U. S. Army,
Director of Purchases and Con-
tracts. [103]

EXHIBIT E

War Department Price Adjustment Board

POLICY AND PROCEDURE

Purpose of the Board

The Price Adjustment Board will serve as a focal point for the review of contracts existing between the War Department and its contractors. Its duties will be to make sure that the War Department is doing an economical job of purchasing and that contractors are not making excess or unreasonable profits on war orders. In its review of contractor profits the Board will endeavor to eliminate from contractor cost calculations exorbitant items of whatever nature.

The Board will assist the Services in securing an adjustment in contract prices that will accomplish the foregoing objectives.

The Board will also serve contractors who feel that their contract prices are such that a likelihood exists that they will make excessive or unreasonable profits. It will invite war contractors finding themselves in this position to consult with it for the purpose of arriving at a fair and equitable voluntary adjustment.

Operating Policies.

The following principles will be observed by the Price Adjustment Board in dealings with contractors:

1. The Board will endeavor to arrange for a readjustment in contract price or to obtain a return

of payments made pursuant to a contract to the extent which will result in limiting the contractor to a fair and reasonable profit.

2. In judging the reasonableness of profit, the Board will consider: [104]

(a) the total profit made by the contractor before allowance for federal income and excess profit tax.

(b) the amount of profit per unit based on estimated or actual cost.

3. In determining the estimated or actual cost per unit of performance of the contract, the Board will give consideration to all items of cost, including the following:

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

4. The Board will in general be guided by the cost accounting system regularly utilized by the contractor, except that the Board will, in appropriate cases, disallow salaries, bonuses or other expenditures which are clearly excessive.

5. In determining the amount of profit to be viewed as reasonable, the Board will give proper consideration the following:

A. The first factor in determining the attitude of the Board toward the contractor will be based on the contribution that the contractor has made [105] and is making to the completion of the war production program.

B. Whether the contract is performed in whole or in part with facilities furnished by or financed by the Government.

C. The amount of invested capital employed by the contractor in the performance of the contract.

D. The ratio between this investment and sales volume.

E. The period of time required to perform the contract.

F. The complexity or simplicity of the manufacturing operations involved.

G. The presence or absence of exceptional risks to be borne by the company.

H. The degree of skill and management and organization required of the contractor. In this connection special attention will be paid to the extent to which the Government has been called upon to arrange for furnishing "know-how" to the contractor.

I. The contribution that the contractor has made to the technical improvement and development of war materiel and production methods.

J. Special consideration will be given those

contractors who have assisted other producers in performing a better job.

6. In cases where performance has been substantially or wholly completed, consideration will be given to the extent to which the contractor has met or anticipated delivery schedules.

7. The Board shall not be limited to the foregoing factors but may give consideration to any other factors which in its judgment are reasonably applicable [106]

Method of Operation.

Information as to concerns making unreasonable profits or those paying excessive salaries or bonuses, or setting up excessive reserves, etc., will be obtained by the Board from the services, Division of Budget & Financial Administration, Contract Clearance Branch of the War Production Board, or any other sources.

All costs analyses are to be prepared by the Division of Budget and Financial Administration.

When the contractor is working for the Navy or the Maritime Commission as well as the Army, that department which has been assigned to the contractor will take charge of the case.

The Price Adjustment Board function will be completed when an agreement is arrived at with the contractor setting a limiting figure that shall be considered a reasonable profit before federal income and excess profit taxes. From this point forward, it is contemplated that the contractor will renegotiate contracts with the Service or Services

involved so as to bring its total profit down to the agreed upon figure.

EXHIBIT F

MEMORANDUM

Pursuant to Executive Order No. 9127, dated April 8, 1942, and for the purpose of controlling profits and costs under war contracts through adjustments with contractors, there have been established with the War Production Board, the War Department, the Navy Department and the Maritime Commission cost analysis sections. Further to implement control of costs and profits on war contracts, the following procedures will be established:

1. The War Department and the Navy Department and the Maritime Commission will each [107] create a board to be known as the Price Adjustment Board of the War Department, the Navy Department, or the Maritime Commission, as the case may be, to advise and assist the official in such Department or Commission in charge of purchasing, in securing adjustments or refunds in instances where it is determined that costs or profits of contractors are, or may be, excessive for any reason. Each board shall exercise such other powers not inconsistent with this order as may be delegated to it by the Department or Commission which created it.

2. The Chairman of the War Production Board shall recommend a representative for appointment to each board. The Price Adjustment Boards may have one or more members in common.

3. The Cost Analysis Section of the War Production Board will conduct general surveys of the profits and costs of holders of war contracts and industry-wide studies of a like nature, either upon the request of one of the Price Adjustment Boards, or of the Cost Analysis Section of any Department, or upon its own initiative.

4. The Cost Analysis Sections of the War Department, Navy Department and the Maritime Commission will act as fact finding agencies for the Price Adjustment Boards and will upon the request of any Price Adjustment Board conduct investigations into the cost and profits of any contracts in which Departments or the Commission are interested. Any such investigation made upon the request of a Price Adjustment Board will be in such form and in such detail and will include such subject matter as such Price Adjustment Board may require. The Departments and the Commission will cooperate with each other in [108] order to avoid duplicating investigations of common contractors.

5. All cost analysis reports and all information obtained from contractors or otherwise by the various Cost Analysis Sections including that of the War Production Board and all information and records of the various Price Adjustment Boards will be available at all times to each of the Price

Adjustment Boards and to each of the Cost Analysis Sections.

6. The Cost Analysis Sections of the War Production Board and of the Departments and the Commission are authorized to make use of the facilities of the Treasury Department, Securities and Exchange Commission, Federal Trade Commission and other proper departments or agencies of the Government in securing and assembling information.

7. Each Price Adjustment Board may establish such policies and procedures for the administration of its proceedings as it may deem proper. Every effort shall be made to keep the procedure of each board simple and flexible. Each board shall keep a written record of each action taken by it. Each board may delegate to any one or more of its members the power to initiate investigations, request information and assistance on behalf of the board and to represent the board in negotiations with contractors.

8. Where contractors have contracts with both Departments or with one or both of the Departments and the Commission, the Price Adjustment Boards of the Department or Commission involved shall agree as to how and by whom the negotiations shall be conducted. [109]

9. No audit shall be made by any Department or the Commission pursuant to Executive Order

No. 9127 without first advising the Cost Analysis Section of the War Production Board.

(Signed) ROBERT P. PATTERSON,
Under Secretary of War.

(Signed) JAMES FORRESTAL,
Under Secretary of Navy.

(Signed) E. S. LAND,
Chairman, Maritime Commission.

Approved:

(Signed) D. M. NELSON,
Chairman, War Production Board.

EXHIBIT G

War Department
Washington

April 25, 1942.

Memorandum for

Directors of all Staff Divisions, Services of Supply.

Chiefs of All Supply Services.

Chief of Each Administrative Service.

Commanding Generals of All Corps Areas.

Subject:

Price Adjustment Board, Services of Supply.

1. There is created within the Services of Supply a Price Adjustment Board.

2. The mission of the Price Adjustment Board shall be to advise and assist the Chief of the Purchase Branch, Procurement and Distribution Division, in securing adjustments and refunds in cases where it is thought that costs or profits of War Department contractors [110] are or may be excessive by reason of the payment of excessive salaries or bonuses or for any reason.

3. The members of the Board will be selected by the Commanding General, Services of Supply, with the approval of the Under Secretary of War. One member will be selected with the approval of the Chairman of War Production Board, as his representative.

4. The Board is instructed wherever appropriate to function jointly with representatives or agencies of the Navy Department, Maritime Commission, and other Departments or agencies of the Government.

5. The Board will receive from the Cost Analysis Section of the War Production Board, the Cost Analysis Section of the Fiscal Division of the Services of Supply, the Supply Services, the Army Air Force, and from any other source, information with respect to contractors who are thought to have excessive costs, to be making excessive profits, or to be paying excessive salaries or bonuses.

6. (a) The Cost Analysis Section of the Fiscal Division of the services of Supply shall upon request of the Board make such audits and analyses as may be designated by the Board and shall secure

for the Board from the Treasury Department, the Securities and Exchange Commission, the Federal Trade Commission, and from any other Department or agency of the Government, or from the contractor involved, such additional information as the Board may request in order to expedite and assist it in the performance of its functions.

(b) All Divisions and personnel of the Services of Supply and the Army Air Force shall furnish such information and assistance to the Board as it may request or as may appear desirable to aid it in the performance of its functions. [111]

(c) To effect full coordination between the Services of Supply, the Army Air Force, and other Departments and to insure a uniform policy, price reductions which are offered to or contemplated by, the Services of Supply and the Army Air Force will be referred to the Chief of the Purchases Branch.

7. The Board is authorized to delegate to any one or more of its members the power to initiate investigations and request information and assistance on behalf of the Board and to represent the Board in negotiations with contractors. The Board shall develop such other policies and procedures as it may deem advisable in performing its functions and accomplishing its purposes.

8. The Board shall report to the Chief of the Purchases Branch, Procurement and Distribution Division, Services of Supply, its recommendations for adjustments with contractors. These recom-

mendations, if approved by the Chief of the Purchases Branch and the Director or Deputy Director of the Procurement and Distribution Division, Services of Supply, shall be transmitted to the Services concerned for the purpose of effecting any renegotiation or revision of contracts required in order to carry out such recommendations.

(Sgd.) BREHON SOMERVELL,
Lieutenant General,
Commanding.

Approved: April 25, 1942.

(Sgd.) ROBERT P. PATTERSON,
Under Secretary of War.

EXHIBIT H

War Department
Headquarters, Services of Supply
Washington

March 13, 1942.

SP-PB-ppp 300.4.

P. B. General Directive No. 31.

To:

The Chief, Chemical Warfare Service.

Chief of Engineers.

Chief of Ordnance.

The Quartermaster General.

Chief Signal Officer.

The Surgeon General.

Commanding General, Transportation Division.

Commanding Generals, all Corps Areas.

Commanding Officers, General Depots.

Subject:

Use of Price Renegotiation Clause in Fixed
Price Contracts.

1. It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts. In any case where in the opinion of the Contracting Officer it is desirable that the Contractor immediately commence production or preparation therefor, the Letter Purchase Order prescribed by P. & C. General Directive No. 5, dated January 13, 1942, may be issued pending such negotiation. Where actual production and delivery may occur prior to the execution of the contract, the words "partial payments and" or words of substantially similar import may be inserted in paragraph 4 of such Letter Purchase Order before the words "advance payments." [113]

2. Where a Letter Purchase Order is employed in accordance with paragraph 1 hereof, the contract should be negotiated at the earliest possible date even though final determination of price is impracticable at that time, and provision should be made in the contract for redetermination or renegotiation of the price, as authorized herein.

3. The Contracting Officer, in order to facilitate the execution of the contract and the commencement of work thereunder, may, pursuant to the authority of the First War Powers Act, 1941

(Public 354, 77th Cong.) and Executive Order #9001, insert in the contract and apply either of the following articles: (a) Redetermination of Price (Attachment 1), or (b) Renegotiation (Attachment 2).

4. It will be observed that Attachment 2 imposes upon the Contractor no legal obligation beyond that of furnishing a statement of actual costs and to renegotiate in good faith. Such statement will afford a basis for renegotiation of the contract price. On the other hand, Attachment 1 calls for the application of definite objective standards, thereby making the redetermination of price largely automatic rather than dependent upon renegotiation.

(Sgd) BREHON SOMERVELL,

Lieut. General, Commanding.

2 Incls: Attach. 1, Attach. 2.

Approved by:

ROBERT P. PATTERSON,

Under Secretary of War.

Attachment No. 1.

Article..... Redetermination of Price.

The parties hereto recognize that, because of circumstances beyond their control, accurate estimates [114] of the cost of performing this contract cannot be made within a reasonable time. Accordingly, they agree that the price stated in Article 1 shall be redetermined as provided below, upon the basis of the actual experience of the Contractor in

performing part of his contract. Such redetermination of the price shall be made as follows:

(a) The estimated cost of performing this contract, upon which the price stated in Article 1 is based, is \$....., itemized as follows:¹

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses²

(State basis of allocation)

Total Factory Cost

- B. Other manufacturing cost
- C. Miscellaneous direct expenses
- D. Indirect engineering expenses
- E. Expenses of distribution, serving and administration
- F. Guarantee expenses

(b) It is agreed that the cost of production of the first% of items called for hereunder, hereafter referred to as the "preliminary run" will not necessarily be typical for the remainder of the contract. The cost of production of the next%, [115] hereafter referred to as the "test

¹This breakdown may be altered to suit particular circumstances.

²State separately the estimated amount of each of the following items included:

- (a) Normal depreciation.
- (b) Special amortization.

run” shall be used as the general basis for re-determination. Within days after the completion of the production of the “test run”, the Contractor shall submit to the Contracting Officer separate statements of the actual cost of the production of the “preliminary run” and the “test run”, itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and accounts to such examination and audit as shall be requested by the Contracting Officer.

(c) If the actual cost of production of the preliminary run plus the cost of the production of the remainder of the items called for by the contract, as indicated by the actual cost of production of the “test run”, is less than the total estimated cost stated in paragraph (a), the total price to be paid pursuant to Article I shall be reduced in the same ratio.

(d) Pending the redetermination of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the re-determination of such price hereunder, an amount equal to the difference between the price paid on all items theretofore delivered and such redetermined price for such items shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned

to the Government as directed by the Contracting Officer.

(e) If this contract contains an escalator clause (Price Adjustment), notwithstanding any provisions of such escalator clause which may be inconsistent herewith, that clause shall be understood to relate only to that portion of the production under the contract [116] which is not covered by the statements of actual cost required by paragraph (b) of this article. The blanks in the escalator clause will be filled in at the time of redetermination hereunder, and the month in which the redetermination is made shall be taken as the base month for such escalator clause and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statements. For this reason the blanks in the escalator clause were not filled in at the time of the execution of this contract.

Attachment No. 2:

Article Renegotiation.

(a) The Contractor represents that the contract price provided in Article is based upon a total estimated cost of \$. itemized as follows:¹

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor

¹This break-down may be altered to suit particular circumstances.

4. Miscellaneous direct factory charges

5. Indirect factory expenses.²

(State basis of allocation)

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

(b) Within days after the completion of the production of% of the items called for under this contract, the Contractor shall submit to the Contracting Officer a statement of the actual cost of the production of said percentage, itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and accounts to such examination and audit as shall be requested by the Contracting Officer.

(c) Upon the written request of either party, which request shall be made within days after the filing of the statement required by paragraph (b) hereof, the Contracting Officer and the

²State separately the estimated amount of each of the following items included:

(a) Normal depreciation.

(b) Special amortization.

Contractor will enter into negotiations and will attempt to agree upon a modification of the contract.

(d) Pending the renegotiation of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the renegotiation of the price hereunder, an amount equal to the difference between the price paid on all items theretofore delivered and such renegotiated price for such items, if in the Government's favor, shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned to the Government as directed by the Contracting Officer; if in the Contractor's favor, it shall be paid by the Government on a separate invoice or voucher.

(e) If this contract contains an escalator clause (Price Adjustment) the figures set forth therein and the terms thereof shall be controlling in the absence of a modification of the contract under this article. In the event of such a modification, the escalator clause shall be so modified as to relate only to that portion of [118] the production under the contract which is not covered by the statement of actual cost required by paragraph (b) of this article. In modifying the provisions of the escalator clause, the month in which the renegotiation occurs shall be taken as the base month, and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statement submitted under paragraph (b) hereof.

EXHIBIT I

Joint Resolution to Provide for the Renegotiation of Contracts for the Production of War Materials for the Purpose of Limiting Profits Thereunder

Whereas it is imperative that effective measures be taken to limit the profits paid to contractors obtaining contracts for the production of war materials; therefore, be it

Resolved by the Senate and the House of Representatives of the United States, in Congress assembled, That—

1. The Secretary of War is directed to insert in any contract hereafter made by the War Department, which, in his judgment, may result in an excessive profit to the contractor, a provision for the renegotiation of the contract price at a period when the profits can be determined with reasonable certainty.

2. The Secretary of War is directed, whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with the War Department, to require such contractor to renegotiate the contract price. This provision shall be applicable to all contracts hereafter made and to all contracts heretofore made, whether or not such contracts contain a renegotiation clause, provided that final payment [119] has not already been made pursuant to such contract.

3. In renegotiating a contract price the Secretary of War shall not make allowance for any

salaries, bonuses, or other compensation paid by the contractor to its officers or employees, in excess of a reasonable amount, nor shall he make allowance for any excessive reserves set up by the contractor, and the Secretary of War shall freely use the powers of audit conferred upon him by existing law for the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been set up.

4. In addition to the powers conferred by existing law, the Secretary of War shall have the right to demand of any contractor who holds uncompleted contracts with the United States for the production of war materials in the aggregate amount of \$500,000 or more statements of actual costs of production and such other financial statements, at such times and in such form and detail as the Secretary of War may require.

5. The authority and discretion herein conferred upon the Secretary of War may be by him delegated to such individuals or agencies in the War Department as he may designate and he may authorize such individuals to make further delegations of such authority and discretion.

6. The foregoing provisions shall be applicable to the Secretary of the Navy in the case of contracts with the Navy Department, and to the Chairman of the Maritime Commission in case of contracts with that Commission. The powers conferred by paragraph 4 above shall be exercised by the

War Department, the Navy Department, or the Maritime Commission, which ever holds the largest aggregate amount of uncompleted contracts for the production of war materials.

[Endorsed]: Filed Jan. 23, 1945. [120]

[Title of District Court and Cause.]

AFFIDAVIT OF H. STRUVE HENSEL IN
SUPPORT OF MOTION FOR SUMMARY
JUDGMENT [121]

City of Washington,
District of Columbia—ss.

H. Struve Hensel, being first duly sworn, deposes and says:

1. I am General Counsel for the Department of the Navy, appointed by the Secretary of the Navy. I was appointed a Special Assistant to the Under Secretary of the Navy in January, 1941, and was appointed Chief of the Procurement Legal Division (which preceded the Office of the General Counsel for the Department of the Navy) upon the formation of that Division in July 1941. I have general supervision over all procurement legal matters in the Department of the Navy, and my office drafts or approves the provisions of Navy contracts.

2. The statements made in this affidavit are based upon information received by me in my official capacity and which I believe to be true and accurate.

I. SCOPE AND COMPLEXITY OF NAVY PROCUREMENT

3. The armed services in December 1941 were faced with procurement problems on a scale beyond anything which they had theretofore experienced. The problems of allocating materials and manpower were enormous. The Army and Navy urgently needed ships, planes, tanks and other munitions of every kind, regardless of cost. The logistics requirements had changed so much and so swiftly with the outbreak of war that the available data on the Government's previous procurement were of very little assistance in [122] fixing prices which would closely reflect the ultimate costs.

4. Prior to the emergency period, all Navy contracts were let as the result of competitive bidding. The first step away from this requirement was taken in the Act of April 25, 1939, when the Congress authorized construction of naval facilities on island bases on a cost-plus-a-fixed-fee basis. In the next fifteen months several further authorizations were enacted allowing the negotiation of cost-plus-a-fixed-fee contracts for construction.

5. The first major expansion in the Navy's war-procurement planning was in June, 1940. Upon the fall of France and the Low Countries, the Congress voted to make substantial additions to the United States Fleet. By December, 1941, Navy procurement programs had been accelerated as demands from the Fleet became more imperative. After December 7, 1941, the procurement tempo skyrocketed.

So many different items were needed in such large quantities, by both the War and Navy Departments, that the Navy Department felt compelled to give a commitment to almost any manufacturer who demonstrated ability to perform the work.

6. In June and July, 1940, the authorized strength of the Navy was approximately doubled. The "11 percent Expansion Act" of June 14, 1940 and the "70 percent Expansion Act" of July 19, 1940 (the Two-Ocean Navy Act) were passed in recognition of the threats to this nation's security implicit in the German victories. These authorizations of increased Navy strength were accompanied by grants of contract authority and the necessary appropriations. The Act of June 28, 1940 (Public No. 671, 76th Congress) granted limited authority to negotiate contracts for vessels, propulsion machinery and equipment, and also [123] granted the necessary authority to construct facilities to build the vessels and munitions. Requests to the Congress for authority to negotiate contracts had emphasized that the Navy had need for utilizing the services of all shipbuilders, all manufacturers of naval ordnance and other munitions, rather than the services of only those making the lowest bids. In point of fact, the contracts let by the Bureau of Ships in late 1940 and the first half of 1941 to carry out the additions to the Fleet authorized by the Congress, in large part tied up the existing naval shipbuilding capacity of the nation. Although new shipbuilding facilities were being constructed and completed throughout the last half of 1940 and 1941, it was not

until early 1942 that the completion of vessels on the ways and the availability of the new shipbuilding facilities made possible the execution of another large group of shipbuilding contracts.

7. The vastness of the procurement programs in 1941 and the early part of 1942, as compared with earlier programs, tended to subordinate all other considerations to the single factor of getting the munitions. The Navy did not during this period have any mechanism for determining close contract prices or for controlling profits under its contracts. More important, neither the Navy personnel responsible for procurement nor the contractors had any experience to enable them to gauge profits accurately. Many contractors were making new items which had never before been manufactured in this country. Manpower problems began to be acute with the acceleration of inductions under the Selective Service Act. No one had any idea as to what effect manufacture of ordnance and other items by the thousands instead of by single items or in small lots would have on profits. It proved generally impossible to make allowance in [124] advance for increased efficiency gained from experience, and the greater profits, resulting from increased volume. In instance after instance the Navy found that costs and profits seemingly reasonable at the start of the contract became unreasonable after volume and experience had increased. The important contracts were so large that a small margin of error in computing prices could wipe out the contractor's capi-

tal. Conversely, allowances for contingencies, intended only for protection, often turned into unexpected profits. Finally, Navy personnel during this period were more interested in getting the munitions than in limiting profits under the contracts for such munitions.

a. Contract Statistics

8. The scope of the problem of acquiring naval supplies and equipment at reasonable prices can be discovered by examination of some Navy statistics for this period.

i. Commitments and Expenditures

9. For the calendar years 1940-1944, the Navy's commitments and expenditures of appropriated funds were as follows (in billions of dollars):

	Fiscal, 1940	Fiscal, 1941		Fiscal, 1942		Fiscal, 1943		Fiscal, 1944	
		7-1 to 12-31-40	1-1 to 6-30-41	7-1 to 12-31-41	1-1 to 6-30-42	7-1 to 12-31-42	1-1 to 6-30-43	7-1 to 12-31-43	1-1 to 6-30-44
Commitments	\$1.1	8.5	4.2	6.0	17.2	13.8	13.0	12.2	12.0
Expenditures	....	0.9	1.7	2.8	6.2	7.6	13.8	12.2	14.9

The commitments represent roughly the amount of contract obligations (including letters of intent) executed; plus amounts for pay, subsistence and transportation of naval personnel (for the fiscal years 1941 to 1944, inclusive, expenditures for these purposes, in billions of dollars, were 0.32, 0.65, 2.01 and 4.8, respectively). It will be noted that commitments in the first [125] half of 1942 almost tripled those of the latter half of 1941, and that expenditures in the first part of 1942 were more than double those of the earlier period. Furthermore, both commitments and expenditures for the second half of 1941 had gone up very considerably over those of the first half of 1941.

ii. Number and size of contracts

10. The following figures indicate the vast increase in procurement contracts during the months of the fiscal year 1942 beginning July 1, 1941 up through April 30, 1942. The figures include all new work awarded, consisting of all new contracts, letters of intent and extensions of existing contracts. Letters of intent were the informal (but nonetheless binding) contracts awarded to a manufacturer in order to authorize him to get started on the work in advance of the time when detailed contract terms or prices could be worked out. They were often used when specifications were not completed, when it was necessary to finance the contractor immediately, or when the detailed terms—including often intricate payment provisions and delivery schedules—might take a long time to negotiate.

(\$1,000,000's)

	1941						1942		
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar. Apr.
Total dollar amount of awards	\$662.8	342.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9 1,953.8
Expenditures .....	.....	.....	.....	\$450	400	700	600	700	1,100 1,200
Total number of awards over \$50,000	541	473	434	587	604	749	1,083	1,085	1,344 1,727

11. The above figures are further broken down by Bureaus as follows:

(\$1,000,000's)

	1941						1942		
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar. Apr.
Nod contracts (signed by Secretary — primarily facilities, vessels)									
\$ Amount	\$73.6	40.0	121.8	79.9	4.9	50.0	37.9	6.3	10.1 33.7
No. over \$50,000	32	31	40	26	7	23	21	15	15 38
NOrd Contracts (BuOrd)									
\$ Amount	\$12.3	23.7	13.2	11.0	61.5	27.2	58.7	35.9	99.4 138.4
No. over \$50,000	8	9	8	22	36	26	25	27	70 87

(\$1,000,000's)											
1941							1942				
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	
NOs, NXs Contracts											
(BuSandA)											
\$ Amount	\$306.3	247.2	372.8	228.7	281.8	724.0	747.7	2,344.4	1,254.5	1,135.5	
No. over \$50,000.....	351	340	318	404	362	477	670	657	735	1,070	
NOy Contracts (BuY&D)											
\$ Amount	\$264.4	25.9	55.4	100.3	110.4	101.4	143.4	145.1	184.2	331.5	
No. over \$50,000.....	128	66	80	120	167	180	230	251	380	326	
NObs Contracts (BuShips)											
\$ Amount	---	---	---	\$0.9	5.5	119.5	361.7	315.8	628.4	230.8	
No. over \$50,000.....	---	---	---	2	15	26	61	78	96	116	
NOa Contracts (BuAero— only facilities)											
\$ Amount	---	---	---	---	\$21.6	2.9	5.4	71.3	21.0	66.1	
No. over \$50,000.....	---	---	---	---	11	4	14	20	27	26	
NOm Contracts (Marine Corps)											
\$ Amount	\$6.2	5.4	2.4	2.2	1.6	4.3	18.2	8.7	5.1	9.4	
No. over \$50,000.....	22	27	8	13	6	13	56	37	21	55	

Throughout this ten-months' period, the Bureau of Supplies and Accounts executed all contracts for the articles specified by the Bureau of Aeronautics (except facilities) and for a great many of the articles specified by the other Bureaus. In September and October 1941, the Secretary delegated his power to execute negotiated contracts to the Chiefs of the several Bureaus; this fact accounts for the change in distribution of the contracts awarded following such months.

iii. Decline in use of competitive bids

12. The following table shows the predominance of the negotiated contract as compared with contracts let after competitive bids during the period in question:

	1941							1942		
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
Competitive bids	\$ 96.9	78.4	88.9	87.5	101.1	121.8	112.1	73.7	67.9	107.2
Negotiated contracts (including letters of intent and extensions of existing contracts)	\$505.1	250.0	457.1	311.4	362.0	869.2	1,222.6	2,803.2	2,112.6	1,835.3

(\$1,000,000's)

Under the old competitive bid contract, used prior to the emergency, there was almost no pricing problem—the contract was awarded to the lowest bidder. It is true that a modified system of competitive bids was used in the award of many negotiated contracts; the Department would request several manufacturers to submit, more or less informally, their estimated prices. The manufacturer submitting the low price would, other conditions being equal, receive the bulk of the Department's order for the item to be procured. In many cases, the Department would negotiate contracts with all of the manufacturers submitting prices; the high bidders would receive contracts for lesser quantities than the low bidders. Under this modified form of bidding, however, there was some negotiation in the arrival at the final contract price, and pricing was much more of a problem than it had been under the earlier system of competitive bidding.

iv. Dollar amount of letters of intent

13. The progressive increase in the use of letters of intent indicates the pressure which was being put upon contracting officers. The following table demonstrates the increasing reliance upon letters of intent: [128]

(\$1,000,000's)

	1941					1942				
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
Total contracts awarded....	\$662.8	342.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9	1,953.8
Letters of intent	\$124.9	20.6	80.1	33.0	23.1	249.6	628.8	2,408.6	1,416.5	860.7
Previous months' letters of intent superseded by contracts executed .....	....	....	....	....	\$48.2	57.6	26.1	53.7	223.7	297.9

The use of letters of intent in the Bureau of Ships is particularly striking:

BUREAU OF SHIPS—CONTRACTS AWARDED

(\$1,000,000's)

	1941, Dec.	Jan.	1942 Feb.	Mar.	Apr.
Total contracts awarded.....	\$119.4	361.7	315.7	628.4	230.8
Letters of intent	\$119.4	361.7	313.5	628.4	225.8
Previous months' letters of intent superseded by con- tracts	\$0.3	---	6.1	---	---

14. In conclusion, the contract figures for the fiscal year 1942, from July, 1941 until the passage of the renegotiation statute, show (1) a great increase in the amount of materiel contracted for, (2) virtual abandonment of competitive bidding as a method of awarding contracts and (3) an increasing use of the letter of intent.

b. General Factors Making Close Prices Difficult

15. A number of factors complicated the procurement programs at this time. These factors were more or less inevitable with the outbreak of war and the huge spurt in procurement.

i. Lack of experience

16. The enormous increase in procurement tells its own story. The Navy Department had no experience enabling it to cope with the problem of fixing close [129] prices under the new procurement programs. Contractors were being asked to

produce items in quantities never before contemplated. Thus, in late 1940 and early 1941, contracts for vessels were let in quantities exceeding those of the first World War, and in early 1942, these quantities were still again increased. A single contract for one ordnance item (5" gun mounts) which had theretofore not been made outside Government gun factories, called for a quantity of such items in excess of the total number previously made in this country in the gun factories. Many other examples could be cited.

17. Contractors were called upon to manufacture new items which had never before been produced—such items as radar equipment, new plane and vessel designs, floating drydocks, and Bofors and Oerlikon guns. Specifications for some items were not completed until the contract was performed; the requirements for other items were changed constantly through the life of the contract.

18. Many contracts were long-term contracts which extended for more than one year. The majority in dollar volume of combatant ship contracts were contracts for twelve months or more. Similarly, most of the contracts for construction of public works and facilities, and for air frames and engines were long-term contracts. The bulk in dollar amount of contracts let for these items in the fiscal year 1942, prior to passage of the renegotiation statute, ran until 1942 or 1943. Almost all aircraft and construction contracts were let on a cost-plus-a-fixed-fee basis. Of the contracts for vessels, a larger dollar amount were made on the fixed-price basis,

but these fixed-price contracts were made subject to adjustment and escalation in respect of direct labor and material costs. [130]

19. Contracts were awarded to many contractors, particularly in the aircraft industry, in amounts tens and evens hundreds of times greater than their capital investments.

ii. Problems in building up procurement personnel and organization

20. For the fiscal year 1940, obligations of Navy appropriated funds totalled approximately 1.1 billion dollars; for the fiscal year 1941, obligations were about 12.7 billion dollars, (note the table in paragraph 9 above). In fiscal 1942 total obligations were 23.2 billion dollars, with obligations in the second half of such fiscal year (i. e., the first half of calendar 1942) amounting to 17.2 billion. The dollar volume of obligations incurred in the first six months of 1942 was comparable to the dollar volume of obligations incurred in the preceding two and one-half years (2.8 billion dollars less). The great jump in contract obligations which took place in the second half of 1940 was largely due to the great expansion in shipbuilding authorized in mid-1940, and, to a somewhat lesser extent, to the expansion in plane authorizations and construction of public works and facilities.

21. Within two years, the procurement machinery of the Navy had to be stepped up to the point where it could turn out, in a six-months' period, contracts for munitions for about thirty-one times the dollar amount of the obligations incurred in the

first half of 1940 (approximately \$0.55 billion—50% of the \$1.1 billion commitments recorded for the twelve months of fiscal 1940—as compared with \$17.2 billion in the first six months of 1942.) The difficulties of turning out the contracts for the widely diversified items procured by the Navy (from battleships to buttons, from planes to pork products) increased rather in a geometric progression as the dollar amount of Navy needs [131] and the number of Navy contracts necessary to fulfill such needs multiplied.

22. The Navy Department started its emergency procurement program in June, 1940, with personnel adequate to handle one billion dollars of procurement per year; it was impossible, within the year and one-half which followed, to build up the personnel who could handle procurement at the rate of 34 billion dollars per year (17.2 billion dollars for the first half of 1942), and at the same time achieve close pricing on the munitions for which contracts were being written. Even if there were in the country enough persons skilled in procurement problems and analysis of costs to undertake to fix close prices on munitions, such persons would have had no background of experience in the prices of a large proportion (if not most in dollar volume) of the items procured by the Navy. Not only was the Navy Department purchasing many items which had never before been made by the contractors, but it was also purchasing items in such quantities in 1941 and early 1942 that previous price experience was almost useless as a guide.

23. It is most important to recognize that pricing was only one of the factors which had to be considered by the Navy Department in expanding its procurement. The enormous increase in the number of technical personnel — engineers, architects, designers—required to handle the specifications for Naval materiel can be understood readily enough. Another factor too often overlooked is the mechanical problem of getting out completed contracts. The Bureaus, which prepared all of the contracts, had to set up entirely new contract organizations. The coordination of procurement by the Bureaus became increasingly difficult—what had been relatively simple when procurement was at the rate of one billion dollars a [132] year became extremely complex when procurement jumped twelvefold, and then twenty-three fold. Many different efforts at coordination were made; the agencies most responsible for unifying contract policies—the Procurement Legal Division of the Under Secretary's Office and the Office of Procurement and Material of the Secretary's Office—were not established until July, 1941 and January, 1942, respectively. Organizations to assist contractors—in obtaining priorities, solving labor problems, building facilities, securing capital—all had to be established and manned, and it took time for such organizations to acquire the necessary know-how. Other organizations were required to coordinate Navy procurement policies and procedures with the policies and procedures of other Government agencies, to prevent the competition for

contractors which helped to demoralize the early procurement of World War I.

24. The Navy Department had made a fair beginning towards solving these many problems at the time war was declared. The declaration of war, however, at the same time rendered imperative the immediate functioning of all of the agencies necessary to handle the procurement problems, and also made the problems much more acute. Through all of the process of organization for wartime procurement, the contracts had to be turned out, and in far vaster quantities than theretofore. One partial solution, of course, was the issuance of letters of intent rather than the more formal contracts, which could be worked out thereafter. The figures which I have cited earlier indicate the extent to which this device was used in the period under consideration. The use of letters of intent, however, merely postponed the day when the more formal contract was to be written; and at several times the backlog of letters of intent became perilously [133] large. And the problem of pricing still remained when letters of intent were used. The Department did issue some letters of intent under which prices were fixed, but as a general rule, the letters of intent were silent as to prices, with the understanding that prices would be set later in the definitive contract.

25. The Navy Department was struggling, throughout the year and one-half prior to passage of the renegotiation statute, to obtain personnel to get out the specifications, to write the contracts, and to aid in the production, of the materiel required. In-

deed, we have not today completely solved this problem—we still have need of experienced personnel who can take over the constantly changing procurement problems.

iii. Uncertainties as to costs

26. Added to the absolute lack of experience as to the cost of many items and the difficulties inherent in training personnel to meet new problems of theretofore unrivalled magnitude, were the many uncertainties as to certain costs—in 1941 and 1942 the scarcity of materials and of manpower, and rising prices and wages, made particularly difficult the forecasting of costs.

27. The problem of material shortages became acute in early 1942. The predecessor to the War Production Board had been established to administer the priorities authorized by the "Navy Speed-Up Act" of June 28, 1940. The Army and Navy Munitions Board had been working with the War Production Board and its predecessors for the one and three-quarter years prior to April, 1942, in enforcing a system of priorities in metals for Government contracts. In the first half of 1942 the armed services and the War Production Board were engaged in working out a system of control much stricter than that theretofore in [134] effect—the Production Requirements Plan, which was put into effect on July 1, 1942. The application of all of the priority ratings was an immensely complicated job, which was administered in the Navy Department by the Production Branch of the Office of Procurement

and Material. In addition to the metals covered by the priority schedules, there were several other raw materials which were at this time extremely critical because of shipping losses and other factors.

28. At this same time also, manpower shortages were beginning to be felt as the draft was stepped up enormously, although the shortage in manpower became most critical some months later.

29. The armed services had experienced some labor and wage troubles at the plants of contractors. The most acute cases were, of course, those of North American Aviation, Inc., which was taken over by the War Department under Executive Order No. 8773 dated June 9, 1941, and Federal Shipbuilding & Dry Dock Co., which was taken over by the Navy Department under Executive Order No. 8868, dated August 23, 1941. Wages were rising, from early 1941 onward. In mid-1941, the Navy took the initiative in having the nation's shipbuilders enter into zone agreements with respect to labor. These agreements, while they helped to insure a supply of labor, had the undoubted effect of raising labor costs at most shipyards, including those not covered by the agreements, which tended to raise wages for all shipyard workers. There was also established a shipbuilding stabilization program reimbursement policy, to which the Navy Department, War Department and Maritime Commission adhered; the three agencies have from time to time issued administrative instructions governing reimbursement to shipbuilders of specific labor costs. Zone agreements somewhat similar to those in the

[135] shipbuilding industry were likewise established for the construction and building-trades industries.

30. Wages continued to rise throughout late 1941 and the first part of 1942, and the trend was not effectively checked until after the President's "hold-the-line" Executive Order 9250 (promulgated upon passage of the Second Emergency Price Control Act of 1942 on October 2, 1942) which empowered the President to establish wage ceilings. Overtime charges began to mount in late 1941. As the War and Navy Departments demanded speeded-up production and extra shifts, they promised fixed-price contractors, who had not contemplated substantial overtime wages at the time their contracts were let, that the contract prices would be adjusted in the light of the overtime payments.

31. Scarcity of materials and growing scarcity of manpower made for higher costs to contractors. From the very inception of the national defense program, contractors were fearful of price rises which might wipe out not only their profits under long-term contracts, but also their entire companies. They were therefore insistent upon protection by the Government against such price rises. From the latter part of 1940 on, escalator clauses were demanded with increasing frequency under fixed-price contracts. In 1941 and early 1942, I should judge that the great majority in dollar amount of fixed-price contracts provided escalation in some form or another. Many contractors faced with the production uncertainties which I have outlined above, in

addition to price increases, insisted upon cost-plus-a-fixed-fee contracts to protect themselves.

32. Increases in production and in efficiency were so swift that in many cases the increased costs which had been anticipated and were to be covered by escalation [136] were completely swallowed up in the greater than anticipated profits earned by contractors. It had been, and still is, generally impossible to forecast accurately the effects upon costs, of increased volume or of the productive efficiency of Navy contractors. In addition to this fact that contingent costs (against which escalation was provided) were offset by unanticipated profits, the fixed price under any contract containing an escalator clause invariably also contained allowances for many contingencies not covered by escalation. Escalator clauses did not provide complete protection against fluctuation in costs; there were at the time many uncertainties as to overhead costs against which the contractor claimed to have no protection except amounts for contingencies included in his contract price. In practice, price escalation worked only upwards, although the escalator clause generally did provide for revision downwards of prices based on direct labor and material costs, as well as for revision upwards thereof. The cost-plus-a-fixed-fee contract was virtually a riskless contract. As the production of so many contractors increased many times over, the return in profits under fees fixed upon the volume of their business amounted to vastly more on their capitalization than had profits prior to the emergency and war periods.

33. Manufacturers demanded protection against the uncertainties facing them; the Navy Department, which had no means of forecasting costs, of necessity had to provide the protection in its contracts in order to obtain the munitions. In general, Navy contractors in 1941 and early 1942 were including in their fixed-price or estimated cost (under cost-plus-a-fixed-fee contracts) allowances for almost all contingencies which could conceivably happen. Almost never did more than a portion of such contingencies happen with respect to a single contractor. In addition, production [137] techniques improved so much more rapidly than expected with respect to a great many items that actual costs in quantity procurement were far lower than those which might reasonably have been expected.

iv. Navy contracting and pricing personnel

34. As the statistics earlier cited make clear, most of the increased procurement from mid-1940 to April 1942 (and to date) has been accomplished under negotiated contracts. A very substantial proportion of these contracts were cost-plus-a-fixed-fee contracts, including almost all construction contracts and plane contracts; all facilities contracts provided for reimbursement of costs to the contractor. With respect to the fixed-price negotiated contracts, it was necessary to negotiate prices with the contractors on the basis of estimated costs. The cost of performance was to the extent based upon past experience, but past costs were generally stepped up by the inclusion of allowances covering the many

uncertainties facing the contractor. The contractor would not undertake the work without adequate protection—and the Navy Department had no valid argument, in the light of the uncertainties as to costs facing the contractor, for rejecting allowances for the protection of the contractor. There was always the possibility, of course, that not all of the contingencies against which protection was being provided in the price would occur, but no one in the Navy Department or anywhere else was able to forecast what contingencies would occur and what ones would not. It is true that many of the fixed-price contracts provided escalation for certain costs, but the inclusion of escalation was necessary in such cases to provide the further cushion without which the contractors would not undertake to risk the hazards inherent in a fixed price. [138]

35. Prices under contracts awarded after competitive bids were of little aid in determining prices for similar items under negotiated fixed-price contracts. Bidders for Navy contracts submitted bids on the basis of comparative prices and of what they anticipated would be the lowest price, rather than on any very close analysis of costs. In any event, the quantities specified in these earlier contracts and the conditions under which they were let did not afford any precedent for pricing in the later period. With the advent of the negotiated contract, more and more of the nation's industrial capacity was converted to Government work. Competitive forces ceased to have any bearing upon prices—in

practical effect, all contracts let were based upon crude estimates of costs, however faulty the early estimates might be, plus an additum for contingencies and profit. As the House Naval Affairs Committee discovered, prices under negotiated contracts were generally lower than prices for comparable items under contracts let to the lowest bidder.

36. At the beginning of the emergency period (June, 1940), the outlook of the Bureaus relative to prices were slanted almost entirely toward purchasing on the competitive bid basis. The Bureau of Supplies and Accounts continued to award some contracts during this period of early 1942 on the basis of competitive bids. Several of the Bureaus had personnel who dealt with comparative prices, based on past experience; such personnel sought to work out prices with contractors. The Bureau of Supplies and Accounts, which had been purchasing standard items in quantity for years, did have some comparative data on prices, based on the competitive bid awards. But, as procurement vaulted to quantities many times the quantities purchased before the war, this data became increasingly obsolete. [139] It was true that the Stock, Schedule and Statistical Sections of the Bureau kept records of past purchases and that such records would be of value in ascertaining the propriety of a negotiated fixed-price. The other Bureaus had only a handful of personnel engaged in drafting of contracts and pricing thereunder, and began in the latter part of 1940 to build up their contract divisions.

37. The new contracting personnel necessary to handle the increased volume of procurement, gradually gained experience with pricing; their training took time. At the start of the emergency procurement, there was on hand inadequate data as to contractors' costs, and consideration of prices offered by contractors was based largely on comparison with prices paid by the Navy for similar munitions in the past, usually under very different conditions. Past experience naturally offered little guide in the determination of prices to be paid for articles which had never been built before, as we discovered in the cases of destroyer-escorts and anti-aircraft guns, for example.

38. As of April 28, 1942 the Navy Department did not have any working organization whose primary responsibilities were analysis of prices and advice in the negotiation of accurate prices which when compared with costs would not allow undue profits. The Cost Analysis Section and the Price Adjustment Board had just been established in the Office of Procurement and Material (itself organized on January 30, 1942) attached to the Secretary's Office, and had had little opportunity to accomplish anything in the way of recommending price reductions. There was no agency—and would not be until July or August, 1942, when the Price Negotiation Branch of Supplies and Accounts was set up—which was in negotiating a [140] procurement deal solely responsible for checking into the contractor's probable costs and for seeking to determine whether the prices submitted should be re-

duced. A lot of thought had gone into the matter of high prices and excessive profits, and we were slowly moving toward corrective measures which proved to be effective. It is true that before the war, almost half in dollar amount of negotiated contracts were let on a cost-plus-fixed-fee basis, or on a cost basis in the case of facilities, and a substantial portion of contracts were still being made to the lowest bidder after solicitation of competitive bids. Past experience was of little assistance in the latter case. Most of the large profits earned by Navy contractors were due to increased volume or ability of the contractor, making a new article with which he was unfamiliar, to reduce his costs promptly, and to allowances for contingencies which did not arise. The Navy Department did not have the pricing experience at this time to deal adequately with these factors. Again I want to point out quite frankly that the Department was primarily interested in getting the munitions as promptly as possible. In the haste to acquire the material of war, it had also to expand and develop its procurement organization. The Navy Department had at the time neither the knowledge nor the experienced personnel necessary to achieve close pricing—and indeed, during wartime, it may be doubted whether anything but limited success in negotiating prices to reflect costs can be achieved.

c. Specific Contract Prices During This Period
(July, 1941-April, 1942)

39. Naturally, as contractors gained experience, and as the Navy became better able to analyze costs,

it has [141] been possible to negotiate lower prices on a great many items. I have listed some of the factors which made for high prices and high profits. I submit some actual examples of prices under contracts let during this period and subsequent reductions of these prices.

i. Bureau of Ships

40. The Bureau of Ships was responsible in 1941 and 1942 for the expenditure of a larger dollar volume of appropriations than was any other Bureau (although the Bureau of Supplies and Accounts in the months prior to passage of the renegotiation statute was writing a larger dollar volume of contracts, because of the large number of contracts such Bureau wrote upon requisition from the other Bureaus). The value of ships completed and converted under Navy contracts rose from about \$142,-146,000 in the second half of 1940, to \$720,494,000 in the first half of 1942, to \$3,590,509,000 in the first half of 1944. For the fiscal year 1941 (July 1, 1940-June 30, 1941), expenditures by the Bureau of Ships totaled \$912,000,000, as compared with \$3,-074,000,000 for the next fiscal year, and \$9,384,000,-000 for the fiscal year 1944 (June, 1944, estimated).

41. The contracts necessary to fulfill the 11% and 70% expansions of the Navy (authorized by the Congress in June and July, 1940) were largely awarded by the end of the first quarter of 1941. In general, these contracts, which each specified the delivery of a number of combatant ships, were not completed until the latter part of 1942 and 1943.

On the average, the following lengths of time are required to complete the several combatant ships:

Battleships	32 to 35 months
Aircraft carriers	17 to 21 months. (The escort carriers require about 11 months.)
Cruisers	22 to 25 months
Destroyers	7 to 13 months
Destroyer Escorts	7 months
Submarines	11 months

42. I have had compiled data on some 13 contracts executed between July 1940 and February, 1941, covering combatant ships. These contracts, all of which were made on a fixed-price basis, subject to adjustment according to changes in direct labor and material costs, provided a total of \$750,097,400 (before adjustment) of contract prices. None of these contracts was completed until late 1942 or 1943. They were completed at a total cost to the contractors of \$514,720,566. The total profit under the contracts, disregarding adjustments and disregarding renegotiation and voluntary refunds, would therefore have amounted to \$235,376,834, or 45.7% of the cost of performance. The cost of performance included increases in labor and material prices during the lives of the contracts, whereas the contract prices as above stated have not been adjusted upward in accordance with escalator adjustments to which the contractors would have been entitled under their contracts. Since the basic month for escalator purposes was between July, 1940 and February, 1941, and the expenditures were incurred from one to two years later, sharp upward adjustments

would have been required if escalation had been computed—it is estimated that such adjustments would have amounted to 10 to 15% of the cost in the case of destroyers, and 15 to 20% of the cost in the case of the larger vessels. As examples of the discrepancies between original unit contract prices and unit costs to the contractor under these contracts, I cite the following:

		Number of Ships	Original Unit Price	Average Unit Cost	Difference as Percent- age of Costs
Destroyer Program					
1st contract	6		\$7,159,700	\$5,445,225	31.5
2nd contract	6		6,813,200	4,560,074	49.5
3rd contract	8		5,379,000	4,705,896	14.3
4th contract	5		7,360,000	4,900,245	50.2
5th contract	17		6,813,000	4,425,605	53.9
6th contract	6		5,977,000	4,241,268	40.9
7th contract	4		5,579,000	4,620,142	20.8
Carrier Program					
1st contract	2		43,662,000	26,625,000	64.0
2nd contract	1		42,725,000	26,500,000	70.6
3rd contract	3		46,125,000	26,600,000	73.4
Cruiser Program					
	2		19,272,500	14,725,000	30.9
Submarine Program					
1st contract	13		2,795,000	2,246,761	24.4
2nd contract	25		2,765,000	2,246,761	23.1

At the time of the award of the above contracts, there was an informal understanding between the Bureau of Ships and the contractors that if actual costs proved to be out of line with the prices fixed, some adjustments would be made. In practice, since none of these contracts was completed until after the passage of the renegotiation statute, all were renegotiated under the statute.

43. Both the destroyer-escort program and the landing-craft program were launched in force in early 1942, although the great majority of contracts for these vessels were not executed until after passage of the renegotiation statute. In neither case had the contractors or the Navy Department had any experience [144] with building these new types of vessels, and original costs were naturally high, because specifications were constantly changing on the early vessels. No contracts for destroyer-escorts were made prior to passage of the renegotiation statute. Work had been begun, however, on several of the vessels, and general agreement on an estimated cost of \$3,300,000 per vessel was reached in the first part of 1942. All of the contracts for these ships except one was made on a cost-plus-a-fixed-fee basis, and the resulting actual costs of the ships indicate the difficulty of arriving at a fair estimate for an item which has never been made before. Actual costs under eight contracts varied from \$1,440,198 per vessel to \$2,667,583 per vessel (the next highest being \$2,348,578). The total fees fixed on the eight contracts amounted to 11.87% of the actual cost. Under the single fixed-price contract, which

provided a unit price of \$3,500,000, actual unit costs amounted to \$1,809,644, or a profit without renegotiation of 93.4%. As I have earlier indicated, the contractor who took work on a fixed-price basis was entitled to cushions for the many contingencies which might arise and wipe out his profits. There was a definite agreement with respect to the destroyer-escort contracts that as costs were more accurately determined, prices and estimated costs would be adjusted accordingly. The Navy Department was in no position to insist upon the elimination of cushions from the price of a ship which had never before been built, with all of the uncertainties as to costs facing the contractor.

44. With respect to propulsion machinery, I shall repeat an example which was submitted by Secretary Knox to the Congress in April, 1942.¹ Secretary Knox said: [145]

“For example, one of our suppliers with whom we had a contract for 200 destroyer turbines produced the first turbine on our designs at a cost of \$2,559,000, which was very substantially above what that company’s engineers had estimated the cost would be. After the production of 15 turbines, through economies of operation and increased efficiency, this cost was reduced to \$607,000 per turbine. It is now estimated by the company that it will not be until after completion of the seventy-second turbine that the cost will drop to the figure estimated

¹ Hearings before the House Naval Affairs Committee on H.R. 6790, 77th Cong., 2d Sess., April 16, 1942, page 2922.

in quoting to the Navy the contract price of \$300,000 per turbine. This latter cost the company believes will be stable."

ii. Bureau of Ordnance

45. During this period in question, a very large amount of ordnance items were procured under contracts made by the Bureau of Supplies and Accounts. Expenditures by the Bureau of Ordnance increased from \$377,000,000 for the fiscal year 1941, to \$1,915,000,000 for the next fiscal year and \$3,634,000,000 for the fiscal year 1944.

46. Typical of the increase in volume of ordnance procurement is the jump in production under Navy contracts of one antiaircraft gun from approximately 1,000 in the last half of 1941 to about 10,500 in the first half of 1942; another gun jumped from 300 to 1,000 over the same two periods (top production of this item was reached in the second half of 1943 with 3,800 production). Production of Navy ammunition multiplied many times over in 1942.

47. The progressive reductions in prices of two types of antiaircraft guns which had not prior to the present emergency been manufactured in this country is most striking. These guns have been manufactured [146] for the most part by former automobile manufacturers, who had obviously had no prior experience in their production. The Oerlikon gun (20 mm.) with one type of mount was manufactured under one contract made September 9, 1941 for a price of \$7,531.42 per gun; under a contract

dated January 20, 1943 with another manufacturer, its price had been reduced to \$4,519.97, with a still different type of mount, a contract for the Oerlikon guns dated September 22, 1942 specified a unit price of \$6,330; the later contract with the same manufacturer dated May 5, 1944 had brought the price down to \$3,666. This same type of gun was made without mounts under a contract dated June 8, 1942, fixing a unit price of \$4,958.50; the present contract with the same manufacturer dated May 5, 1944 specifies unit prices ranging from \$2,133 down to \$1,708 as production increases.

48. The Bofors gun (40 mm.) prices show equally astonishingly decreases. The original contract dated January 7, 1942 specified a unit price of \$4,288 (without mounts); the later contract with this manufacturer dated November 11, 1943 brought the price down to \$2,510.

49. Prices of 20 mm. and 40 mm. projectiles have come down to about 50% of the original prices. These items are items as to which the changes in specifications have not presented the problem present with respect to many naval munitions. Quantities produced under Navy contracts have multiplied many times over during the past three years, and the price reductions may be attributed in large part to increases in volume. Production of the 20 mm. shells was begun in June, 1941 under eight contracts specifying unit prices which varied between 21.5c and 25.23c per shell; the most recent contracts in January and May of 1944 specify prices from 11.2c to 14.46c per shell. Similarly, [147] production of

40 mm. projectiles began in June and July, 1941 under eight contracts with prices ranging from 64c to 84c per unit; the latest contracts, executed in August and November, 1943 and September, 1944, provided payment of between 43c and 50c per shell.

50. Prices of other ordnance items have indicated how difficult it is to arrive at a price under the original contracts. One model of gunsight has dropped from \$2,638.29 to \$1,571.19. A case for depth charges which originally cost the Government \$15.07 was later reduced to \$10.31. Three-inch gun-barrel forgings were priced at \$1,580 under the original contract of May 5, 1941; under the contract dated November 21, 1942, the price had gone down to \$1,000.

iii. Bureau of Supplies and Accounts

51. This Bureau purchases all of the standard supplies, hardware, clothing, subsistence items and the like. The Bureau both prepares the specifications and writes the contracts for most standard supply items — hand tools, repair materials, furniture, stock items and the like. In 1941 and 1942 the Bureau of Supplies and Accounts also wrote a great many contracts for the other Bureaus, which drew up the specifications for the items to be procured, negotiated the price, and then sent a “requisition” covering the procurement to the Bureau of Supplies and Accounts to be written up in contract form.

52. Total expenditures of the Bureau (for items as to which it both prepared the specifications and wrote the contracts) increased from \$563,000,000 in

fiscal 1941 to \$1,409,000,000 in fiscal 1942 and to \$6,127,000,000 in fiscal 1944. These figures include expenditure of very substantial amounts for pay, subsistence and transportation of naval personnel. A very large [148] proportion in dollar amount of the Bureau's total procurement consists of petroleum products.

53. The prices under Navy contracts of most of the subsistence items and clothing items are so closely related to material costs that volume procurement does not have any appreciable effect upon the prices. I do not therefore present any examples of purchases of either subsistence or clothing items.

54. I shall cite several examples of reductions in the prices of some standard stock items largely as a result of purchasing in large quantities. Thus, twist drills are purchased under contracts for hundreds of thousands of dollars; the unit prices for these drills in different sizes and specifications vary from 8 or 10c to several dollars. Prices under a 1944 contract with one manufacturer for assorted lots of drills were $22\frac{1}{2}\%$ less than prices under a 1942 contract with the same manufacturer. Another item of hand tools—hand taps—are purchased in a very wide variety of sizes and prices. Prices under a 1944 contract for hand taps show a decrease of 20% under the prices specified in a 1942 contract with the same manufacturer.

56. Comparison of prices of sisal rope of a certain specification under two contracts with the same manufacturer shows the following unit prices:

Size of Rope	Price per pound	
	1942 contract	1944 contract
3/4"	\$0.195	\$0.1835
1 1/8" .....	.19	.1763
1 1/2" .....	.1825	.1619
4 1/2" .....	.175	.1547
8" .....	.175	.1547

The differences per pound are in cents and fractions of cents; but as the contracts involve several [149] hundreds of thousands of pounds of rope, these differences become quite large in total.

56. The difference is even more substantial in the case of steel cable. One of the early contracts, made in 1941, specified a price for certain 1/8" steel tow cable of \$0.051 per foot; the contract for the same type of cable with the same manufacturer in 1944 provided a price of \$0.037 per foot—a decrease of \$0.014 per foot, or 28%. The later contract required delivery of 30,000,000 feet of cable, so that the total decrease from the original price amounted to \$580,000.

57. Paint brushes under two contracts about 10 months apart (both executed in 1944) with the same manufacturer decreased from \$2.95 to \$2.61 for one size, from \$2.67 to \$2.34 for another; again, the difference is substantial under a contract for 105,578 brushes.

58. Perhaps a comparison of prices of nuts and bolts under a 1943 contract and a 1944 contract will bring home as cogently as any other comparison the difficulty of close pricing on small standard items. Under the earlier contract, the price for one 1/2" by 5" bolt and nut was \$2.86 per hundred, while the

price under the later contract was \$2.12 per hundred; the prices for a $\frac{3}{4}$ " by 6" bolt and nut were \$7.51 per hundred as compared with \$5.30 per hundred. Even more striking is the difference between the prices for a 1" by 5" bolt and nut—\$14.90 per hundred under the first contract, and \$10.10 under the second.

iv. Bureau of Aeronautics

59. All contracts for aircraft and aircraft components during 1941 and 1942 were drafted and executed by the Bureau of Supplies and Accounts, although prices and terms under these contracts were negotiated by the Bureau of Aeronautics. Expenditure of appropriations [150] for which the Bureau of Aeronautics was responsible increased from \$194,000,000 in fiscal 1941 to \$1,052,000,000 in the next fiscal year, and \$4,696,000,000 in fiscal 1944. Total aircraft accepted (reflecting earlier contracts made) increased 122% from the first half of 1941 to the second half of 1941; acceptances in the first half of 1942 were 210% of acceptances in the preceding six months; and the second half of 1942 saw acceptances more than 200% of those for the first half of that year.

60. The contracts for airframes during this period were, with one exception, all cost-plus-a-fixed-fee contracts. They were invariably long-term contracts, in general extending over 18 months or more. The airframe manufacturers required cost-plus-a-fixed-fee contracts at this time, for their margin of capital in relation to total business was so small that

they could not afford to incur any risks. For example, the Grumman Company had a capital of \$5,000,000, yet its contracts with the Navy approximated half a billion dollars.

61. In the contracts for both airframes and engines, innumerable changes in specifications are made during the life of the contract.

62. One cost-plus-a-fixed-fee contract for torpedo bomber frames was let on March 23, 1942, at an estimated unit cost (plus fee) per plane of \$101,863. This same contract was later converted into a fixed-price contract providing for incentive payments as reductions were made below specified costs, and as of September 30, 1944, the unit redetermined price was \$58,050. A cost-plus-a-fixed-fee contract for scout bomber frames was made on February 2, 1942, at an estimated unit cost (plus fee) of \$34,019 per plane; the present contract for the same frames is on the basis of \$30,160 estimated unit cost. Finally, a contract [151] made May 23, 1942, on a cost-plus-a-fixed-fee basis provides an estimated unit cost of \$63,985 for fighter frames; the most recent contract for these frames (fixed-price adjusted contract) calls for a unit price of \$39,000.

63. Similar decreases are evident in the procurement of engines and propellers. Prices under 1941 and 1942 contracts for three different types of engines and two types of propellers, and prices under more recent contracts for the same articles may be compared as follows:

	Old Contract			Latest Contract		
	Date	No.	Unit Price	Date	No.	Unit Price
1st Type Engine	9/10/41	204	\$14,500	12/29/43	439	\$11,200
2nd Type Engine	7/29/41	2,293	13,151	12/29/43	400	11,051
3rd Type Engine	7/14/41	80	6,522	12/29/43	1,400	5,848
1st Type Propeller	4/ 4/42	259	1,081	12/23/43	583	878
2d Type Propeller	3/30/42	248	2,266	12/29/43	3,375	1,880

64. The procurement of aircraft components likewise shows striking reductions in contract prices as the items are produced in greater quantities and as mechanical problems are surmounted. The following table shows the reductions in prices which have been effected for some items:

	Old Contract		Latest Contract	
	Date	Unit Price	Date	Unit Price
Motor Alternator	4/27/42	\$280.00	5/15/44	\$173.00
Starter—1st type	3/ 1/42	370.00	3/ 4/43	333.00
Starter—2nd type	2/ 2/42	355.00	12/ 2/43	290.00
Generator	9/11/41	343.00	7/11/44	229.00
Navigational Watch	5/28/41	30.25	3/23/44	28.45
Oil Pressure Gauge	10/16/41	2.35	11/10/43	1.95
Compass	8/22/40	43.50	4/13/44	35.72

v. Bureau of Yards and Docks

65. The expenditures of the Bureau of Yards and Docks increased from \$412,000,000 in the fiscal year [152] 1941 to \$1,076,000,000 in the fiscal year 1942, and \$2,265,000,000 in fiscal 1943. The Bureau's work reached its peak in the second half of 1942, when some \$1,768,625,000 of work was reported completed on projects under the supervision of the Bureau of Yards and Docks. The great bulk of this work was done under contracts which had been made prior to passage of the renegotiation statute—indeed, many of them were made in 1939, 1940

and 1941, when some of the large contracts for base projects and advance bases had been let. The Bureau of Yards and Docks supervises construction of industrial facilities under the facilities contracts made by the other Bureaus.

66. The peak in the making of construction contracts and the peak of construction thereunder was reached in 1942. Commitments for all types of facilities (industrial and non-industrial) for the first half of 1942 totaled \$2,742,100,000, for the second half of 1942, \$1,420,400,000; expenditures for work completed in these two six-months' periods were \$1,275,000,000 and \$2,190,000,000, respectively. The bulk of facilities contracts executed in the last six months of 1941 and the first four months of 1942 extended beyond the date of passage of the renegotiation statute on April 28, 1942.

67. It has been estimated that roughly 80% in dollar volume of construction contracts and extensions thereof made by the Bureau of Yards and Docks in fiscal 1942 required over 8 months to perform. Most of the very large construction contracts for construction of new bases extend over more than 12 months. It is of course impossible to compare costs or prices of different construction jobs, although prices of construction materials may be compared.

68. As to items procured by the Bureau of Yards and Docks, I shall cite as examples two items—pontoons [153] and floating dry docks. The pontoon program was started near the end of 1941 with

an order for a few thousand pontoons; the number contracted for multiplied over six times in 1942, and increased in 1943 far beyond what anyone had anticipated. The Bureau procures two major types of pontoons, one of which is procured in numbers about 9 times as large as the other type. Prices have come down as follows:

	1st type	2nd type (procured in the larger quantities)
1941 (includes development costs)....	\$440	\$660
1942	335	370
Late 1942 .....	....	250
1944	270	200

Construction of floating dry docks began in 1941. These were an entirely new item, and extensive changes in specifications and design were made during the life of the early contracts. All of these contracts extended beyond April 28, 1942.

II. ACTION BY THE NAVY DEPARTMENT WITH RESPECT TO EXCESSIVE PROFITS

69. The Navy Department in 1941 and the early part of 1942 had only begun to build up machinery for the purpose of ascertaining and recapturing excessive profits under its contracts. I have pointed out the enormous increase in the number of contracts and in the volume of Navy procurement during this period, and the impossibility of acquiring experienced personnel forthwith, to negotiate the best possible prices for the Government. During the period in question [154] (the latter part of 1941

and the first four months of 1942), the Navy Department discovered that some of its contractors were earning very large profits. We endeavored to correct the situations which came to our attention. It proved impossible then to achieve close initial pricing under most Navy contracts. After our experience of the last several years I am convinced that it will always be impossible in wartime to arrive at close prices for munitions, when the Government is uncertain as to the types or quantities of munitions which are needed (and the exigencies of war are such that we are almost never certain as to types and quantities).

a. 1941 Investigations

70. In the first half of 1941, both the House Naval Affairs Investigating Committee and the Truman Committee sent out questionnaires relative to profits to manufacturers and shipbuilders holding Navy contracts. The Truman Committee in June, 1941, conducted hearings upon costs and profits under ship contracts and contracts for ship repair and alteration. These investigations brought out the fact that very large profits were being enjoyed by some contractors; the Truman Committee was particularly concerned with profits under ship repair and alteration contracts. Before these Committees had published any reports, however, the Navy Department made efforts to correct some of the contract prices, particularly under the ship-repair contracts. The first step was to make sure that the Bureau of Internal Revenue would treat a

voluntary refund by a contractor as a reduction in his contract price and in his taxable income; in response to inquiries by the Navy Department, the Treasury Department in September, 1941, indicated that for tax purposes it would so regard such a refund, provided the original contract was modified in writing to indicate [155] the reduced price. Thereafter the Treasury further indicated that a refund made after completion of performance of the contract would likewise be regarded for tax purposes as a reduction of gross income.

71. Mr. Forrestal (then Under Secretary) and Rear Admiral Samuel M. Robinson (then Chief of the Bureau of Ships) in September of 1941 requested the Compensation Board to investigate the cost records of contractors who were to complete ships under Navy contracts in 1941 and the first six months of 1942, and to determine what the probable profits in the construction of those ships would be. The Compensation Board was an administrative agency which had been set up by the Secretary of the Navy in the first World War to review costs under cost-plus contracts, and to advise the Secretary generally on amounts claimed by contractors under Navy contracts. Its functions in reviewing costs under contracts had been taken over largely in late 1941 by the Cost Inspection Service of the Bureau of Supplies and Accounts (the Cost Inspection Service was given complete responsibility to inspect costs under cost-plus-a-fixed-fee contracts, except those made by the Bureau of Yards and Docks, by a directive of the Secretary dated

February 9, 1942). The Compensation Board planned to have its accounting branch, the Cost Inspection Board, go over the cost records of contractors under outstanding vessel contracts and attempt to estimate what the profits would be under such contracts. It was anticipated that in cases where the profits appeared to be excessive, the Bureau of Ships, acting in conjunction with the Compensation Board, would endeavor to persuade the contractors voluntarily to reduce prices. The Bureau of Ships had estimated that by limiting the investigation to contracts of vessels to be [156] delivered prior to July 1, 1942, performance would be close enough to completion so that a fairly accurate estimate of anticipated profits could be made. Both the Compensation Board and contracting representatives of the Bureau of Ships felt that it would be wise to persuade contractors in advance to modify their contracts to allow readjustment in prices to eliminate excessive profits, if possible—a forerunner of the renegotiation clause.

72. The Compensation Board was unable to early this project to completion. It did begin investigation of costs under the vessels contracts, but the outbreak of war and the transfer of the bulk of its cost inspection activities to the Bureau of Supplies and Accounts cut short the study of excessive profits of naval shipbuilders. The Bureau of Ships, aided by the Cost Inspection Division of the Bureau of Supplies and Accounts, late in 1941 began to carry forward certain of the work projected by the Compensation Board, in that it commenced negotia-

tions with a number of shipyards under the ship repair and alteration contracts for revision of the contract billing rates.

73. At this same time, the House Naval Affairs Committee, acting as a Special Committee to investigate the national defense program, pursuant to House Resolution 162, approved April 2, 1941, was undertaking its study of excessive profits under Navy contracts. The Naval Affairs Committee had in April, May and June, 1941, obtained a list of all contractors with the Navy Department, and it sent out to these contractors a general questionnaire, which required the submission of extensive and explicit information on costs of performance of Navy contracts and profits thereunder. As responses were received from the contractors, supplemental questionnaires drawn to [157] elicit information as to a particular industry, were issued to contractors in different industries. The Committee stated that it had in the second and third quarters of 1941 sent questionnaires to 6,899 contractors holding 16,463 contracts. The questionnaires, which required a considerable amount of effort to fill out, aroused a good deal of protest, and also increased interest in excessive profits on the part of both the contractors and the Navy Department. (These questionnaires and the responses thereto are summarized in the Committee's report issued January 22, 1942, H. Rept. No. 1634, 77th Cong., 2d Sess.)

74. By October of 1941 Representative Vinson, Chairman of the House Naval Affairs Committee, felt that the Committee had acquired sufficient data on profits of Navy contractors to indicate the need

for corrective legislation. While he indicated to the Navy Department that the questionnaires returned to the Committee showed that most of its contractors were realizing only a fair profit, he stated further that profits under certain contracts represented an "unconscionable percentage" of the contract price. Therefore, on October 7, 1941, he introduced H. R. 5787 (87 Cong. Rec. 7713) to provide for the recapture of all profits under Government contracts in excess of 7% of the cost of performance thereof. At about this same time, another bill (H. R. 5739) was introduced imposing a flat percentage limitation of profits under war contracts—in this bill 8% of the contract cost. The Navy Department was opposed at this time and later to the revival of any percentage limitation of profits, such as that contained in the Vinson-Trammell Act. It had had the experience under the Vinson-Trammell Act with such a type of profit limitation, and the officials responsible for procurement in the Department were confident that any [158] reenactment of such a limitation would impede the procurement programs.

75. Some consideration was given within the Department in the last several months of 1941 to the best method of limiting profits by administrative action. The only concrete results of this consideration were the readjustments effected by the Bureau of Ships in payments under the ship repair and alteration contracts. These contracts were in effect requirement contracts—i. e., the contractor agreed to perform, for compensation based upon

reimbursement of cost of materials and a fixed price per man-hour of work, all orders for ship repair or alteration work which might be placed with him by the Navy Department. Around the 1st of December, 1941, the Bureau of Ships began to seek voluntary reductions in rates from the shipyards. Between December 1, 1941, and April 1, 1942, the Bureau in effect renegotiated 27 ship repair and alteration contracts, representing a very substantial portion of the outstanding number of such contracts. At hearings before the Senate Naval Affairs Committee on profit limitations late in January and early in February of 1942, Captain Claud A. Jones (Assistant Chief of the Bureau of Ships) indicated that the Navy had recovered about \$2,000,000 in profits by renegotiation of the ship repair and alteration contracts.² This figure does not, of course, indicate the savings which would accrue in the future by reason of the renegotiation of such contracts.

76. The work of renegotiating the prices under these contracts was spurred by publication on January 15, 1942, of the Truman Committee's report, which covered among other things profits under Navy contracts for shipbuilding and ship repair and alteration. On [159] January 22, 1942, the House Naval Affairs Investigating Committee issued its first report on the defense program, which

²Hearings before the Senate Naval Affairs Committee on H. R. 6355, S. 2027, 77th Cong., 2nd Sess., Page 7.

dealt extensively (409 pages including appendices) with the matter of profits under Navy contracts.³ While the Committee noted that average profits under the contracts let by the several Navy Bureaus were not too much out of line, it did indicate some examples of extremely high profits. These profits were unduly high despite the excess profits tax. The whole report dealt with profits in terms of percentages of the contract price. It pointed out that the percentage of profits on sales was greater under uncompleted contracts than under completed contracts, and "that as the defense program progresses, the profits to the contractors are increasing and will tend to increase unless steps are taken to halt the trend." Much emphasis was placed upon this report by the Navy officers responsible for procurement. It also received very wide publicity at the time; the newspapers were full of editorials about the prevention of war profiteering, and the procurement officials of the Navy Department spent a considerable amount of time over the next several months in seeking to devise some more effective means of administratively limiting profits under Navy contracts.

b. Study and Suggested Solutions within the
Navy Department, February-April, 1942

77. From the end of January, 1942 on, the efforts of Navy procurement officials to find some solution to the problem of policing of costs and

³ House Report 1634, 77th Cong., 2nd Sess.

profits were redoubled. While no formal organization had been set up to deal with the matter, several groups were devoting most of their time to an investigation of ways and [160] means for limiting profits. The procurement personnel of the several Bureaus worked closely with the investigating personnel of the House Naval Affairs Committee, and were instrumental in suggesting to the committee most of the contractors whose profits were so large as to merit further investigation. The Department was during this same period attempting to work out a sound organization to handle the entire procurement problem, let alone the matter of war profits. It was on January 30, 1942, that the efforts towards coordinating the divergent procurement activities of the several Bureaus culminated in the establishment of the Office of Procurement and Material in the Secretary's office.

78. At the Under Secretary's request I devoted a large part of my efforts during the months of February, March, and April, 1942, to working out some means of curbing profits under our contracts which would not interfere with the more important objective of obtaining the munitions and supplies required by the Fleet. I spent a great deal of time during this period in discussing this problem with representatives of the Procurement Branch in the newly formed Office of Procurement and Material, the contracting branches of the several Bureaus, and the accounting personnel in the Bureau of Supplies and Accounts. During these three months the Under Secretary also brought into the Department

several men with wide business experience who looked into the entire matter of profits under Navy contracts and who subsequently became members of the Price Adjustment Board (established several weeks prior to passage of the renegotiation statute). The problem of the right way (if there were any "right" way) of handling the problem was, however, still very much in the formative stage—it was not then possible to set up any [161] more definite organization to handle the matter of closer pricing and excessive profits. In February we held several discussions with representatives of the Army procurement services as to the best cure for excessive profits, and considered a proposal to include in war contracts clauses under which the contractor agreed to consider adjustment or renegotiation of the contract prices.

79. Early in March, I submitted to the Under Secretary, on behalf of the Navy group which had been studying the problem, some tentative conclusions. It was the consensus, first, that the Navy Department must continue to rely upon the "profit motive" as an important factor in inducing war production, but that nonetheless, excessive profits had a bad effect on public and military morale and also tended to encourage demands for wage increases and decreases in labor efficiency. With respect to the proposal to limit profits to a flat percentage of the cost of performance of contracts, it appeared probable that industry would insist upon a floor under losses if it were to be subjected to a ceiling upon profits. This floor under losses could

be accomplished only under a cost-plus type of contract, which was expensive to supervise and audit, tended to reduce efficiency, and often permitted very high profits on a yearly basis; and the 7% limitation on the fee allowed under such contracts, while low for some businesses, permitted very high returns for other businesses. The amount of manpower and effort required to audit such contracts or to administer the flat percentage type of limitation under fixed-price contracts would be enormous and probably could not be drafted if this limitation were put into effect. With respect to excess profits, it was our position that corporations must be permitted to retain some portion of their profits in order to [162] preserve the influence of the profit motive and in such event the amount of profits before taxes in view of the extraordinary ballooning in some industries was often so large as to leave excessive profits even after taxes. There was no easy answer to the problem of effective profit control. It was my view at that time that we should attempt to do as much as we could by starting at the very beginning— in the negotiation of contract prices. The Government should be represented in such negotiations by experienced and skillful negotiators who would endeavor to see that the maximum of effort was produced at the right price . We realized then that in the light of all of the imponderables, even skilled negotiators would be unable to achieve close pricing in many instances. It was recommended to the Under Secretary that experienced price negotiators be placed in each of the

contracting Bureaus. This suggestion was discussed at considerable length in various meetings and bore fruit several months later in the establishment of a Price Negotiation Section in the Bureau of Supplies and Accounts, which was ultimately extended to all of the Bureaus of the Navy Department.

80. At about this same time (early March, 1942) as a result of our several discussions within the Department, consideration was given to a proposed directive to be signed by the Secretary with respect to the allowance of reasonable profits on fixed-price negotiated contracts. It was proposed that prices be fixed to allow a profit of 6% generally, but up to 10%, of the estimated cost of the contract, to be determined on the basis of cost data and financial statements submitted by the contractor—in short, an embodiment in each contract of the Vinson-Trammell type of limitation, applied in advance. The directive was discussed in considerable detail on March 13, 1942, by representatives [163] of the several Bureaus, the Special Assistant to the Under Secretary, Vice Admiral Robinson (Chief of the Office of Procurement and Material), and myself. We were agreed at this meeting that the proposed directive would tie the Navy Department completely to the percentage limitation of profits concept, with all of its inherent deficiencies. We therefore decided that we would not recommend that any such directive be signed by the Secretary at this time, and that we would attempt further to devise some effective means of control of profits within the Department. One feature of the proposal was

revived several weeks later—namely, the requirement that the contractor submit statements as to the estimated cost of performance of his contract and other financial data in connection with the performance of Government contracts. Some time thereafter this did become the standard practice.

81. At this same time the War and Navy Departments and the War Production Board had been working upon the establishment in each of the three agencies of cost analysis sections, which would be able to point out profit danger spots and suggest administrative remedies therefor. On March 17, 1942, representatives of the Office of Procurement and Material who had participated in these discussions circulated a proposed outline of procedure for the establishment and workings of such sections. This suggestion provided for the close coordination of the proposed cost analysis sections in the three agencies, and provided further that the War Production Board would attempt to supply a check on the selection of contracts for cost analysis so that the program would not put an unmanageable burden upon the accounting offices of the three Departments. After further discussion of ways and means, the cost analysis sections were set up about [164] three weeks later. The War Production Board was to function primarily in analyzing the cost reports prepared by the War and Navy Departments.

82. In the latter part of March Messrs. Kenneth H. Rockey and Sylvan Coleman came into the Department at the Under Secretary's request to

study the whole matter of excessive profits and closer pricing. Messrs. Rockey and Coleman went over the rather substantial data which we had by this time accumulated and spent considerable time with the contracting officers of the several Bureaus in reviewing contracting procedures and the methods then available for determining whether or not excessive profits were being earned. Both of them took a very active part in the discussions which were then occupying most of the time of the group studying the matter of excessive profits. When the Navy Price Adjustment Board was established about April 20, 1942, Mr. Rockey was made its Chairman and Mr. Coleman was made a member of the Board.

83. In the course of our study, some of the cases of excessive profits enjoyed by subcontractors were brought to our attention. We learned of several instances in which the prime contractor with the Navy Department had given subcontracts to one of its subsidiary companies, and had included in its cost figures under the prime contract allowances for profits of subsidiary contractors. We sought to require representations by the prime contractor which would prevent any repetition of such practice. Of course, we recognized that any scheme of percentage-profit limitation tended to favor high profits for subcontractors; the prime contractor would not be interested in keeping subcontract costs or prices low, since the higher such costs or prices were, the higher the base on which his percentage of profits would be figured. Also, there were [165] some in-

stances where work was subcontracted directly and the fee of the subcontractor was added to the fee of the prime contractor to make for double profits on the same work.

84. During the last week of March, 1942, the House Naval Affairs Investigating Committee held hearings on excessive profits being earned by several large Army and Navy contractors. These hearings were extensively reported in the newspapers, and the large profits earned by the Continental Motors Company and of Jack and Heintz received particular attention. The Naval Affairs Committee had received most of its data on these contractors from a joint audit which had theretofore been undertaken by the Army and Navy. The hearings had the helpful result of producing a number of meetings between Army and Navy representatives for joint consideration of the best means of limiting excessive profits. At such a meeting on March 25, 1942, it was concluded that each Department should have available an organization to which would be reported all cases wherein it was suspected that contractors were earning excessive profits. The meeting envisioned that these organizations would function about as follows:

a. All procurement officers would be advised of the establishment of the two organizations, and requested to refer to them for further investigation cases of excessive profits.

b. A conference would be called between the contractor and representatives of all Government agencies holding contracts with such contractor. At

this conference, the profits would be considered with a view to obtaining for the Government a return profits deemed excessive or a reduction of the contract price by the amount of such profits, whichever might be appropriate. [166]

c. The meeting contemplated that in the cases of recalcitrant contractors, resort might be had to compulsory orders under Section 9 of the Selective Training and Service Act; and further that in appropriate cases full publicity would be given to the excessive profits and the action taken.

The March 25th meeting further determined that immediate action along the lines indicated would be taken jointly by the services in the case of Continental Motors. In general, the War and Navy Departments were agreed that each case should be dealt with on an individual basis, although at the outset it might be advisable to approach a group of contractors (perhaps those mentioned at the hearings of the House Naval Affairs Investigating Committee) and to deal with them in a body. It was agreed that the proposed action would be reported to the Congress to indicate the bona fide efforts being made by the War and Navy Departments to achieve answers to the problems of excessive profits. This meeting really represented the birth of the Price Adjustment Boards.

85. The War and Navy Departments thereafter discussed with the War Production Board this proposal to set up bodies to investigate war profits. Growing directly out of these discussions was the

proposal that a Presidential Board be appointed to serve throughout the war for the purposes of studying the experience of other nations as to profit limitation, formulating a comprehensive program for the prevention of excessive profits, suggesting legislation and procurement policies as deemed appropriate, and dealing with special difficult cases. The proposal contemplated that Congress, the Army and Navy and other war procuring agencies would be able to look to such Board for guidance and advice. [167]

86. By the time this matter was brought up for consideration, however, H. R. 6790, the revival of the Vinson-Trammel percentage limitation, had been introduced (March 16, 1942); and Representative Case had introduced his amendment to H. R. 6868, providing for the renegotiation of contract prices to eliminate all profits above 6% (March 28, 1942). These proposals were discussed with representatives of the Army and the War Production Board, and representatives of the Navy presented to the House Naval Affairs Committee and to the Senate Finance Committee our views with respect to them, and commented upon the several revisions of the renegotiation proposal which were submitted to us.

87. The passage of the Second War Powers Act, 1942, on March 27, 1942, afforded an additional weapon to the Navy Department and the other war procuring agencies in the investigation and determination of excessive profits. Title XIII of this Act allowed the agencies, when so authorized by the President, to inspect and audit the books and

records of their contractors and to require such financial data as they desired. The President, by Executive Order 9127 dated April 10, 1942, delegated this authority of investigation and audit to the procuring agencies, subject to certain conditions. The Departments were enabled to go into the plant of any contractor and require the submission to them of all information as to profits.

88. The Cost Analysis Section and the Price Adjustment Board were formally organized in the Office of Procurement and Material about April 20, 1942, and were specifically called to the attention of all procuring officers of the Department by a memorandum circulated on April 24, 1942. [168]

89. The informal group which had preceded the formal establishment of these two organizations, the Bureau of Ships and the Cost Inspection Division of the Bureau of Supplies and Accounts, had meanwhile in the first four months of 1942 continued to readjust and renegotiate contract prices. The accomplishments of the Navy Department in reducing prices up through June of 1942 were summarized in the report of the House Naval Affairs Investigating Committee of July 22, 1942.⁴ The Committee had obtained the names of specific contractors investigated and a great deal of the data on the excessive profits which they were enjoying, from the Departments. The Committee included in its report a summary of the "actual monetary savings to the Navy Department" as a result of renegotia-

⁴H. Rept. No. 2371, 77th Cong., 2d Sess., pp. 26-32.

tion of contracts. It indicated that the Navy had effected such savings to the extent of some \$88,000,000. While the Committee did not so indicate, the great bulk of this amount constituted reductions in contract price rather than returns of cash received by the contractors. Furthermore, as the Committee did point out, the renegotiations effected at that time would later show substantial results in lowering prices on new contracts for the munitions for which the original contracts had shown excessive profits. With respect to the ship repair and alteration contracts, the Committee remarked that refunds under these contracts amounted to \$7,000,000 (which is to be compared with the \$2,000,000 which had been recovered by the end of January, according to Captain Jones' testimony). As the volume of ship repair and alteration work had increased under these contracts, profits had expanded rapidly under rates which had been fixed in the absence of any adequate experience in this type of work. Under contracts [169] of this type, the Bureau of Ships had been fairly successful in renegotiating profits to allow no more than 10% of costs (as compared to an average profit on such contracts prior to their readjustment of 30% of their cost of performance).

90. I am unable to present any concrete figures from the Navy Department as to the total cash refunds of profits by Navy contractors prior to April 28, 1942. Apparently all of the cash refunds were collected by means of deductions from vouchers; no record had been kept of any such deductions, and

it would be an interminable undertaking to examine the vouchers under each contract in the anticipation that they might reveal voluntary reductions in price. In addition, any recapitulation of the cash refunds would not show the whole picture, for most of the savings to the Government in the elimination of excessive profits were effected by means of price reductions.

c. Consideration of the Percentage Profit Limitation Proposals

91. Meanwhile, the Congress had been considering several proposals to impose a percentage limitation of profits upon Government contracts, and there appeared at the time to be a very strong chance that such a method of limitation would be enacted by the Congress. These proposals, to which the Navy procurement officers were unalterably opposed, naturally spurred the efforts within the Department to arrive at a solution to the profit limitation problem. On March 16, 1942, there had been introduced in the House H. R. 6790, which proposed among other things to limit profits on all Navy contracts to 6% of the cost of performance thereof. The bill was referred to the House Naval Affairs Committee, which held a number of hearings upon it in late March and April 1942. [170]

92. Both Mr. Forrestal and Col. Knox testified with respect to H. R. 6790. Mr. Forrestal called attention to the vast amount of auditing work which would be necessary to enforce any such limitation, and discussed our experiences under the Vinson-

Trammell Act. The Secretary, who testified on April 16, 1942, brought out the immense variety of factors which affected profits under a particular contract and the impossibility of any single cure for excessive profits applicable to all contracts. He pointed out one very important consideration which the Congress had not thus far emphasized—the importance of reducing costs to the Government as well as profits. As he suggested, high costs and reduced profits often went hand in hand, and high costs could be much more expensive to the Government than high profits.

93. The Navy had had some experience in the difficulties of obtaining good accountants and auditors to handle the growing dollar volume of cost-plus-a-fixed-fee contracts. In early 1942, there were in the Cost Inspection Service of the Bureau of Supplies and Accounts, which audited costs under these contracts, some 2700 accountants (most of whom were stationed outside Washington); in addition there were a substantial number of accountants in the Bureau of Yards and Docks, which audited its own construction contracts. H. R. 6790 proposed to have costs under Government contracts determined by reference to Treasury Decision 5000 (the regulation under the Vinson-Trammell Act), which was then used as a guide for auditing costs under the cost-plus-a-fixed-fee contracts. The determination of costs was a burdensome and time-consuming job, and there were substantial differences of opinion as to what items were properly allowable costs. The complete post-audit of expen-

[171] ditures under the cost-plus contracts by the General Accounting Office, after audit by the services, further complicated the difficulties of administering the cost - plus - a - fixed - fee contracts. It seemed clear that there would not be enough accountants in the nation to scrutinize costs under every Government contract, as contemplated by H. R. 6790, in the same way that costs were scrutinized under the cost-plus contracts.

94. H. R. 6790 was tabled in committee, for the renegotiation bill had been brought to the fore by the Congress. Section 403 of H. R. 6868, as reported out by the Senate Appropriations Committee, contained in subsection (f) a graduated range of percentage limitations to be applied to Government contracts of different size. Representatives of the Navy Department joined the representatives of the other war procuring agencies in discussing this subsection with the Senate Committee, which ultimately agreed that the percentage limitation feature should be deleted.

d. Maximum Price Controls

95. The matter of price controls upon munitions was considered by the Under Secretaries of the Navy and War and the Price Administrator in late 1941. They decided at such time that it would not be necessary to set up any formal machinery for handling differences of opinion between the armed forces and the Price Administrator with respect to prices, but that each problem would be handled as it arose. The situation was changed substantially by

the approval on January 30, 1942 of the Emergency Price Control Act of 1942. The armed services had in the consideration of the bill which became the Price Control Act recommended that munitions be expressly exempted thereunder, but their suggestion [172] was rejected. The possible imposition of maximum price ceilings on munitions pursuant to this Act was a rather unsettling factor in the whole discussion of possible methods for control of profits during the next several months. At the time of passage of the Act, the Price Administrator had not determined upon a policy as to the establishment of ceilings for the purpose of preventing war profiteering and of controlling prices under contractors for war materiel. On the day the renegotiation statute was approved—April 28, 1942—the Office of Price Administration issued its “Big Freeze” order, the General Maximum Price Regulation, and its Machinery and Parts Regulation (Maximum Price Regulation No. 136). The coverage of these regulations included a great many items of completed munitions and almost all components thereof, although certain specified munitions were to be exempted from the price ceilings established under the Regulations. Broadly speaking, the General Regulation fixed the price ceilings by reference to the prices in effect during March 1942, and required specific authority from the Office of Price Administration for the fixing of ceilings where there were no analogous March 1942 prices; and the Machinery and Parts Regulation fixed ceilings by reference to the prices in effect

October 1, 1941, and also required specific authority from the Office of Price Administration in cases where there were no analogous October 1, 1941, prices.

96. The issuance of these regulations precipitated an immediate and prolonged discussion between the armed services and the Office of Price Administration as to the desirability of fixing price ceilings for munitions and their components. As a stop-gap measure, the Price Administrator postponed application of the regulations to sales and deliveries under Army [173] and Navy contracts until July 1, 1942. In the latter part of May 1942, the Under Secretary of the Navy established a liaison office in the Bureau of Supplies and Accounts, which was to integrate the price policies of the Navy Department and the Office of Price Administration insofar as possible.

97. It had been the position of the Army and Navy in all of their consideration of price control that it would be unwise and impracticable to apply price regulations to strictly military and naval equipment, and that attempts to do so ran the risk of impeding procurement of such equipment. It was felt that the services responsible for war procurement must have final power over prices; such services were charged with full responsibility for procuring the articles with which to fight the war, and proper prices might well be an inextricable element in such procurement. In the latter part of July 1942 the Under Secretaries of War and of the Navy notified the Price Administrator that

while they recognized the necessity of adopting all possible means to prevent inflation, they felt that it was necessary to exempt military and naval supplies from the application of price ceilings. The Under Secretaries pointed out the difficulties inherent in effectively applying ceilings to munitions—e. g., the wide variety of conditions and uncertainties faced by contractors, the changes in specifications, inexperience of contractors, necessity of using all contractors and procuring all items regardless of cost. They further pointed out the probable impediment to production and procurement which the imposition of price ceilings would bring about, the undesirability of divided authority with respect to procurement, and the uncertainty and delay which would result from the application of the price regulations to Army and Navy contracts. Finally, they requested that “all [174] articles which are designed and produced exclusively for military uses, and all subassemblies and parts of such articles which are themselves designed and produced exclusively for such military articles” be exempted from price regulation by the Office of Price Administration, with the exception of articles subject to regulation prior to June 30, 1942; that in questionable cases exemption be granted upon certification by the Secretary of War or of the Navy that the exemption was necessary for the prosecution of the war. The Under Secretaries pointed to the authority to renegotiate contract prices under the recently enacted renegotiation statute as a means at their disposal

of controlling excessive profits and preventing inflation.

98. After further consultation, the Price Administrator responded in September 1942 by indicating that he would not extend maximum price control in the area of strictly military goods, provided he received assurances that the Army and Navy would use their powers to control both prices and profits in the exempted areas. He further indicated willingness to consider any requests for exemption of particular items at that time under formal price regulations. The Office of Price Administration agreed not to extend price control to sales of strictly military goods. It was understood that the exact line of demarcation between military and non-military goods would have to be more precisely drawn after conferences among the three agencies. The War and Navy Departments accepted the proposal as drawn by the Price Administrator, and agreed to furnish his Office with such information as it requested on the prices and procedures of the two Departments. Thereafter the armed services did establish divisions which furnished to the Office of [175] Price Administration all information on prices requested by such Office.

99. Prior to the passage of the renegotiation statute, the top Navy officials in charge of procurement had spent a very considerable amount of time in seeking to evolve some answer to the extraordinarily difficult problem of limiting war profits while at the same time executing the vastly accelerated procurement programs.

100. There was virtual unanimity of opinion that the percentage limitation of profits was not a solution to the Navy problem—experience indicated that it was not effective and that it made contractors hesitant to take Government contracts. Indeed, it made many manufacturers want to become subcontractors rather than prime contractors. The limitation of adequate accounting personnel was an even more compelling practical reason for the rejection of this means of profit control. Similarly, we had neither the inclination nor the necessary personnel to extend the use of the cost-plus-a-fixed-fee contracts to fields where in we were able to use fixed-price contracts. We knew from actual experience that exorbitant profits were being earned despite the recoveries under the excess-profits tax. The proposal to subject munitions to price ceilings had been seriously considered by the time of passage of the renegotiation statute, although the matter was not settled until the latter part of 1942.

101. The Navy Department was, then, in early 1942 in the position of opposing the known and theretofore attempted methods of limiting war profits, either because some of them were ineffective or because others would in the opinion of those responsible for procurement seriously interfere with war production. We would quite frankly have preferred at this time to work out our own administrative solution to the problem of limiting profits under Navy contracts, primarily [176] through analysis of costs and closer pricing. The solution proposed by the Congress in the renegotiation statute, however, ap-

peared to us to be a much better method than any alternative statutory method available. In retrospect, I believe that it is the better approach and that our earlier preference would not have solved the problem.

III. NAVY CONTRACT FORMS AND CLAUSES

102. The advent of the negotiated contract completely changed the form of the Navy contract and made necessary the use of much more intelligence and skill in the preparation of contracts.

103. Contracts awarded to the highest bidder after solicitation of competitive bids had all been based upon Forms 32 and 33 prescribed by the Procurement Division of the Treasury Department for all Government agencies. Such forms of contract, with their boilerplate provisions, were satisfactory only for simple deals, and proved quite inadequate for negotiated contracts. The first break away from these restrictive forms came in the preparation of construction contracts and contracts for the construction or installation of industrial facilities (in 1939 and 1940). In developing provisions for the facilities contracts—financing the contractor, purposes for which the facilities were to be used, rights of the parties upon the termination of the emergency period, and the like—it was obvious that the contract would have to be tailor-made to fit the particular arrangement. Furthermore, in the course of drafting these various provisions to

fit the procurement transaction, the boilerplate provisions were scrutinized and were often improved or made more appropriate. The grant of authority to negotiate certain contracts for vessels and supplies (in June 1940) further accelerated the process of [177] critical examination of the contract provisions and the drafting of intelligible new provisions to meet particular needs.

104. After enactment of the First War Powers Act, 1941, and the promulgation of Executive Order No. 9001, the Secretary removed entirely the restrictions of Form 32 in the preparation of negotiated contracts. The Secretary's directive of December 28, 1941, established a new internal Navy procedure for clearing contracts negotiated under the War Powers Act; in addition, it delegated to contracting officers complete discretion with respect to the form of such contracts; except for certain specified provisions required by statute or executive order. Under this delegation of authority, contracting officers were granted complete discretion to make advance, partial, and other payments on account of the contract price,

“ * * * without limitation as to amount and irrespective of any provisions of law as to security, liens (except as [to the lien in favor of the Government as permitted by the Act of August 22, 1911, 34 U. S. C. 582]) or otherwise, except that advance payments should be carefully scrutinized to determine whether such payments are necessary for the satisfactory performance of the contract in accordance with the terms thereof and as much

security by means of controlled accounts or otherwise shall be provided for as may be expedient under the circumstances of each case."

The directive further specified:

"Such contracts [under the War Powers Act] may be made with or without competitive bidding as the respective contracting officers in their discretion may determine. There shall [178] be no limitations or restrictions as to form and substance of such contracts except [the contract clauses required by statute or executive order].

* * * * *

The contracting officers are authorized to select such procedures in making contracts as are deemed best fitted to the purchases involved and the needs of the Navy."

105. At this time all instructions relative to contracts were in the form of individual directives by the Under Secretary to the Bureau Chiefs, who transmitted such instructions to the officers under them responsible for preparing contracts. Since the great majority of Navy contracts were made by the Bureaus in Washington, these directives could be rather informally issued and distributed. In general, they gave a wide degree of discretion to the Bureaus in the preparation of contract provisions. As we began to pay more close attention to prices and the elements which went into prices, it became necessary to issue more detailed instructions relative thereto; it was not until October 1943, however, that we were able to collect the contract directives

in one place, arrange them, and issue them in a loose-leaf volume (the Navy Procurement Directives).

106. I shall summarize very briefly the more or less common Navy contract provisions prescribed in the first several months of 1942 for the determination or adjustment of prices or costs.

i. Changes

107. All Navy contracts included provisions for changes in the work covered thereby. The changes clause in all Bureau of Ships contracts was broader than that in other contracts made by the Navy.

The Bureau of Ships clause provided:

“The Secretary of the Navy, at any time and without notice to the sureties, may make changes in this contract including the General Provisions, the plans or specifications of this contract, within the general scope thereof.”

This type of clause had been in ships contracts since the 1880's. The broad language of the clause had, by construction, been somewhat limited in scope. The clause was eliminated about a year ago, and the ships contracts now contain provisions limiting changes to the work under the contract, as in other Navy contracts.

108. With respect to changes in price upon a change in specifications or in the work under the contract, the more or less standard clause for fixed-price contracts provided that if the changes caused an increase or decrease in the cost of performing the contract, “an equitable adjustment” would be

made and the contract modified in writing accordingly; facilities and cost-plus-a-fixed-fee contracts provided that upon the making of changes "an equitable adjustment of the estimated cost and the fixed fee would be made and the contract modified accordingly." In the event of failure to agree upon a change in the fixed price or fixed fee, the matter was to be decided by the contracting officer pursuant to the disputes clause of the contract. The cost-plus-a-fixed-fee contracts for vessels provided specifically that if the estimated costs were changed as a result of changes in specifications, the fixed fee, which was stated to be about 7% of the estimated cost, should be changed by 7% of the change in the estimated cost.

ii. Payments

109. The contracts provided specific procedures for submission of invoices covering costs under cost-plus [180] and facilities contracts, and for prices of goods delivered under fixed-price contracts. These provisions varied substantially among the different types of contracts.

110. Fixed-price contracts for vessels called for partial payments as construction of the vessel progressed. The provisions for advance payments under fixed-price contracts specified that a lien should be established in favor of the Government on the materials and property acquired by the contractor. In some instances controlled accounts were established, providing a check by the contracting officer upon the advance payments to the contractor; the ad-

vance payments clauses were at this time relatively simple as compared to clauses presently in use.

iii. Insurance and Bonds

111. All contracts required the contractor to carry insurance on the property produced or acquired thereunder, and to carry workman's compensation and other third-party liability insurance with respect thereto. The Government generally undertook to make the contractor whole for losses sustained in excess of the amounts covered by insurance taken out at the direction of the contracting officer.

112. After passage of the War Powers Act, performance and other bonds were largely dispensed with, although they were still required for certain standard supply contracts made by the Bureau of Supplies and Accounts. In any event, the performance, payment and similar bonds had never been of much use to the Navy. It had invariably proved impossible to obtain bonds at any cost in the cases where they were most needed. Generally the cost of bonds was high and the amounts of coverage in the case of large contracts were entirely inadequate to protect the Government. [181]

iv. Patents

113. Whenever patents were involved in the procurement, the standard clause of the Treasury Procurement contracts was used—the contractor agreed to hold the Government harmless against claims for infringement of patents in the performance of

the contract. Some ships contracts contained the further requirement that the contractor not pay any sum for royalties or patent rights not included in the ordinary purchase price of parts embodied in the ships, unless and until duly so authorized by the contracting officer. No real progress was made in the matter of controlling royalties and other payments relative to patents under Navy contracts, and in drafting patent clauses which adequately protected the interests of the Government, until after the Procurement Legal Division was authorized to handle such matters in August, 1942.

v. Termination

114. Navy contracts (except Bureau of Ships contracts) at this time provided that in the event of cancellation for the convenience of the Government, the Navy would pay the contractor for all costs, including a proper allocation of overhead expense to the contract, incurred up to the time of termination, plus an allowance of 6% or 7% profit on all such costs except purchases of materials and unfinished goods, for which the contractor was reimbursed at cost. This provision differed from the clause then used by the Bureau of Ships and the Army, which calculated the profit on the estimated extent of completion of the contract—the contractor was paid a percentage of the total profit equal to the percentage of completion. The use of any clause was a vast improvement over the practice in the first World War, when contracts did not contain any termination clauses. [182]

115. Navy contracts, other than ships contracts, also had included clauses authorizing termination for default, corresponding to the delays-damages clause of the old Treasury Form 32—if the Government terminated for default in delivery, it had the right to purchase the goods elsewhere and surcharge the contractor for any additional costs incurred by reason thereof by the Government.

116. After the First War Powers Act, the Navy dropped almost entirely the liquidated-damages clause. At this time there were frequent delays due to changes in specifications, material and labor shortages and the like, and it was often if not usually difficult to hold the contractor responsible for delays in deliveries. In addition, contractors were extremely reluctant to take contracts containing such clauses. As the Navy was interested in getting the goods themselves, and not money damages, it determined to omit this clause generally.

vi. Guarantees

117. Most contracts in early 1942 contained a clause under which the contractor undertook to guarantee for a certain period the performance or durability of the articles covered by the contract in conformity with the specifications. This period varied from 3 months to a year or more. The contractor further undertook to correct or repair at his own expense any deficiencies or failures in the contract articles during such period. The ship contracts provided for trials, and adjustments and corrections by the contractor of the vessels during such

trials. If the contract was a fixed-price contract, the contractor would often include large contingencies in his prices to cover possible expenses during the guarantee period. Since 1943 and 1944 the period of the guarantee has been shortened, and [183] the clause has been entirely eliminated in a few cases from Navy contracts.

vii. Escalator clauses in fixed-price contracts

118. Most fixed-price contracts for any substantial amount in late 1941 and early 1942 contained provisions for adjustment in price upon changes in material or labor costs. I should estimate that a majority in dollar amount of fixed-price contracts executed during this period contained escalator clauses. These clauses varied substantially in scope and in the index selected to measure increases in costs.

119. Some of the more primitive types of clauses had attempted to protect the contractor to the full extent of any cost changes. Almost all of the clauses in use at the time the renegotiation statute was being debated, however, attempted to protect the contractor not against all variations in the cost of labor and materials, but only against such changes in those costs as might be attributed to general changes affecting the entire national economy and thus wholly beyond the contractor's control. The basis for calculating changes in costs under the escalator clauses were in most cases indices representing wage levels (either general or

for a specific industry) and material costs, usually indices published by the Bureau of Labor Statistics.

120. The most important determination in any escalator clause was the selection of the base to which the percentage of change in a selected index is applied in order to calculate the permitted adjustment of the contract price. The base selected varied widely among the several contracts, and was often extremely complicated to compute—requiring in some cases substantial cost accounting. All of the escalator clauses are rather complicated to apply. The computations [184] under most of them were made by the Cost Inspection Service of the Bureau of Supplies and Accounts. We have subsequently discovered certain errors in the drafting and application of certain clauses, whereby increases were computed on costs including the price increases against which the escalator clause was designed to protect the contractor. We corrected such increases as they were called to our attention.

121. All escalator clauses are to some degree inflationary and are harmful in that respect. The device had many disadvantages—it was used only because the Navy could not persuade contractors to take contracts on any other basis. Because of the uncertainties as to labor and other costs and the impetus to inflation which any war provides, contractors refused to run the risk of being tied to a fixed-price under a long-range contract. Escalator clauses were to be used only in long-term contracts. Our need for munitions was so great, however, that we could not quarrel very much over inclusion of

such provisions. It must not be assumed that because an escalator clause was included in a contract, the price fixed therein did not include any allowance for contingencies. As has been made quite evident later, the price did include substantial allowances for contingencies. Furthermore, as I have indicated, the escalator clause was not a complete answer to the contractor's insistence upon protection. The clause purported to protect him only against certain direct labor and material price increases and did not protect him against other labor and material costs or other indirect costs which were subject to real fluctuation. The device was an imperfect one which it was necessary for us to adopt in order to speed procurement. Even with the elimination of the risks covered by the escalator clauses, contractors were able in some instances to make profits aggregating 50% or [185] more of cost, as witness the ships contracts which I earlier cited.

122. On January 30, 1942, the Emergency Price Control Act was approved. The adjusted increases in contract prices under the escalator clause had to stop at any ceilings established by the Price Administrator on articles purchased or produced under the contract. At that time it was not known just how the Act would affect price escalation; subsequently specific escalator clauses have been worked out for contracts covering certain materials subject to OPA ceilings.

IV. NECESSITY OF THE RENEGOTIATION STATUTE

123. Had the renegotiation statute not been enacted, I am convinced that Navy procurement would have been affected in the following ways, among others:

- a. greater use of cost-plus contracts;
- b. enforced use of mandatory orders to obtain munitions with respect to which agreement on price could not be reached;
- c. reluctance on the part of contractors to take prime contracts, including preference for subcontracts; and
- d. excessive profits and waste.

These probable results are to a large degree all tied together. We should have found it more and more difficult, I believe, to allow the large contingencies demanded by contractors in fixed-prices, and should therefore have been driven to a much wider use of the cost-plus-a-fixed-fee contract and the mandatory order. I have earlier described the lack of incentive to reduce costs which is inherent in the form of the cost-plus-a-fixed-fee contract, and the large number of auditing personnel required to determine allowable costs under such contracts. Mandatory orders constitute a somewhat ponderous means of procurement, and leave the [186] Government with the pricing problem still on its hands, plus possible court proceedings. There can be little doubt but that profits would generally have been larger in the absence of renegotiation. After a

study of the complex problem of limiting profits in war to fair and reasonable amounts—the problem both as we faced it in the past and as we have faced it in this war—I know of no other type of profit limitation which can take into consideration the many diverse factors affecting the profits of different contractors and fairly adjust those profits, as adequately as does the renegotiation process. The growing Congressional and public criticism of exorbitant war profits in 1941 and 1942 would have resulted in an increasing reluctance on the part of manufacturers to take war contracts, and eventually in some form of profit limitation less palatable and less equitable than renegotiation. I am strongly of the opinion that, while the Government should consistently seek to improve its negotiating procedures in arriving at close prices, the problems of war procurement render impossible any completely satisfactory solution of the problem of initial pricing. Renegotiation, which affords a review of prices after the contractor has had the cost experience in the performance of his contracts, is to my mind an essential part of wartime procurement, today as well as in early 1942.

H. STRUVE HENSEL.

Sworn and subscribed before me this 28th day of December, 1944.

LUCILLE HOLLAND

Notary Public, D.C.

My Commission expires Sept. 1, 1946.

[Endorsed]: Filed Jan. 23, 1945. [187]

[Title of District Court and Cause.]

AFFIDAVIT OF R. E. SPAULDING IN OPPOSITION TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT [188]

State of California,

City of Los Angeles—ss.

R. E. Spaulding, being duly sworn, deposes and says:

I am the managing partner in Manlove & Spaulding Mfg. Co., plaintiff herein, and have read the affidavits of Robert P. Patterson, Under Secretary of War, and H. Struve Hensel, General Counsel for the Department of the Navy, and it is in the light of the unfounded assertions as applied to the operations of the plaintiff company contained in those affidavits, among other things, that this affidavit is presented.

No contracts made by this company for the effective dates of the renegotiation ending in the company's fiscal year December 31, 1942, were made with the United States or with any others than with private corporations or private parties, and that this company has enjoyed no privity of contract with the United States Government during and for the said fiscal year ending December 31, 1942; this is admitted by the United States on page 46 of its brief filed herein.

Every contract made by this company was made on a competitive basis for a fixed price and I assume, since we got the contract, that we were the lowest bidders. This company operates hand screw

machines and other precision machinery in the production of parts and for the renegotiation year 1942 produced 900,734 parts at a total sales value of \$405,594.74.

These 900,734 parts were manufactured at a cost of 45.02c each and required an average of approximately fifteen minutes each to produce. [190]

The gross profit before salaries, taxes, etc., amounted to \$211,816.85, but after \$99,733.34 for state and federal income tax, three working partners' salaries, \$75,000.00 and \$26,631.77 for purchase of machinery and facilities for production of these parts, is deducted from the gross profit, there is left a net profit of \$9863.56 or a profit of 1.09 cents on each part manufactured, or 2.4% on sales.

Prior to production of any war materials, this company was able to fix its prices of each article to be manufactured within a few mills of the cost of production and was not in the position of road builders who went into the shipbuilding business and were unable to estimate the cost of building a ship or of automobile builders who went into the business of building tanks and machine guns and had a variation of prices, in the case of tanks of \$67,401.00 for the first estimate and \$39,285.00 in the final price, and in the case of machine guns, \$868.07 the first estimated price, and \$300.59 as the final price.

The experience of the precision machine industry for fifty years has been that it can fix the price from drawings of each article to be manufactured within a few mills of the actual cost of production and

inasmuch as the final profit of this company on each item produced was about 1c each, there should be little controversy on its ability to fix the price without excess profit on the articles it was to produce.

The production of parts by this company has, of course, been on the much larger volume basis than its peacetime operations but the prices are correspondingly [191] much lower per item and it is only by reason of the volume of production that this company was able to make any profit on the basis of about 1c net gain on each part.

State and federal income taxes are, of course, not profits nor are the salaries of working partners and in the light of the statement of the Surplus Property Administration (to be found at page 80 in "Time" for November 20, 1944), is the purchase of facilities and machine tools to be regarded as profit. In that statement it was shown that since the beginning of World War II the Government alone has come into possession of machine tools representing over twenty-five years prewar production of the machine tool industry so that when the final end of this war arrives the tremendous surplus of machine tools will reduce the majority of them to mere scrap value and therefore their ownership cannot be regarded by any stretch of the imagination as profit.

The graphic illustrations and quotations contained in the affidavit of the Under Secretary of War of the inability of road builders and truck builders to estimate the cost of producing ships, tanks, and machine guns is not analogous to our

situation where we have for years been able to fix the cost of production within mills of the proper cost instead of within tens of thousands of dollars as in the case of the examples cited.

So far as this company is concerned, there has never been in fact any renegotiation since what really happened was that we were required to furnish a financial [192] statement of our sales and costs of manufacture after which the so-called renegotiators arbitrarily fixed an amount that we were called upon to pay after deduction of federal taxes and they informed the company that they were not interested in any counter offer or negotiation on our part.

Had this company followed the usual business practice of sound industrial economy and set up reserves for reconversion and the furnishing of jobs to returning veterans, its balance sheet would show a material loss.

To now pay the sums demanded by the Under Secretary of War and Price Adjustment Board would result in complete bankruptcy of this company and sale of all of its physical assets and irrespective of the payment of the sums demanded, the prospects are not bright for providing employment for returning veterans or anyone else.

Practically our entire assets consist of facilities, machinery and tools which, if sold today, would probably not bring 25c on the dollar and at the end of the war would have no more than a scrap metal value, in view of the fact that the productive capacity of machine tools is probably as much as

fifty times the normal peacetime needs of the country and after the war, machines that cost new \$12,000 to \$18,000 each will be nothing but a burden for storage costs and taxes, it will be cheaper to give them away than it will be to keep them and try to put them in operation.

The arbitrary stoppage of the money due plaintiff company from the defendant by the Under Secretary [193] of War has resulted in serious embarrassment in the operations of the company to continue efficient war operation in the face of such arbitrary discouragement.

70% of our 1942 production was identical with the production in 1940 and 1941. The individual orders or contracts for 1942 varied in amounts from 60 cents to \$8000.00 each.

There were no escalator clauses in any of our orders or contracts and all of our contractors held us to the price we bid.

Plaintiffs above named have been refused any information whatsoever as to the facts used as the basis for the unilateral order purporting to determine excess profits.

On April 11, 1944, the following letter was sent to the Secretary of War:

“April 11, 1944

Honorable Henry L. Stimson
Secretary of War
Washington, D.C.

Dear Sir:

On February 2, 1944, Mr. Robert P. Patterson, Under Secretary of War, acting under your au-

thority and pursuant to the Federal Renegotiation Act, made a declaration of excess profits of the Manlove & Spaulding Mfg. Co., a partnership, determining that said partnership for its fiscal year ending December 31, 1942, had made excess profits to the extent of \$110,000.00.

Said company and partnership hereby requests that you forthwith furnish to it a statement of such determination together with a statement of [194] the facts used as a basis therefor and of the reasons for such determination.

Said request is made pursuant to the provisions of section 701 of the Revenue Act of 1943.

Very truly yours,

MANLOVE & SPAULDING
MFG. CO.

By JOS. I. McMULLEN
LEO R. FRIEDMAN
Attorneys''

On April 17, 1944, plaintiffs received a reply to the foregoing letter as follows:

“War Department
Office of the Under Secretary
Washington, D.C.
Price Adjustment Board

Sprar

17 April 1944

Manlove & Spaulding Mfg. Co.
3524 Union Pacific Avenue
Los Angeles, California

Attention: Mr. Leo R. Friedman.

Re: Renegotiation of Manlove & Spaulding
Mfg. Co., a partnership for its fiscal year
ended 31 December 1942.

Gentlemen:

Your letter dated 11 April 1944, addressed to the Secretary of War, has been referred to the War Department Price Adjustment Board for reply.

Section 403(c)(1) of the Revenue Act of 1943 was not made retroactive by the Congress. Under the circumstances the renegotiation to which your letter refers is still under the previous law so far as the furnishing of a statement of facts is concerned. It has not heretofore been the policy of the War Department Price Adjustment Board to furnish such statements and as a matter of equity to the many hundreds of contractors who have entered into bilateral agreements the Board does not deem it proper to change this policy at this time.

For the Chairman:

W. JAMES MacINTOSH

Counsel."

R. E. SPAULDING.

Subscribed and sworn to before me this 26th day of March, 1945.

[Seal] MAX C. HODER,

Notary Public in and for the County of Los Angeles, State of California.

My commission expires May 20, 1946.

[Endorsed]: Filed Mar. 26, 1945. [196]

CERTIFICATE

I, B. D. Gamble, Clerk of The Tax Court of the United States, do hereby certify that I have made a diligent search of the records of this Court with a view to determining whether or not any petition or any action of any kind whatsoever has been instituted in this Court by R. E. Spaulding, L. B. Manlove and P. M. Manlove, co-partners doing business under the firm name and style of Manlove & Spaulding Mfg Co., and I further certify that no petition or action of any kind has been filed of record in this Court by said R. E. Spaulding, L. B. Manlove and P. M. Manlove, co-partners doing business under

the firm name and style of Manlove & Spaulding Mfg. Co. to date.

B. D. GAMBLE,
Clerk, The Tax Court of the
United States.

Dated: Washington, D. C., May 11, 1945.

[Endorsed]: Filed May 28, 1945. [197]

[Title of District Court and Cause.]

STIPULATIONS

It Is Hereby Stipulated and Agreed by and between the parties to this action that the amount of the alleged indebtedness from the defendant corporation, Douglas Aircraft Company, Inc., to plaintiffs is the sum of \$27,580.80 as alleged in the answer of defendant, Douglas Aircraft Company, Inc., and not the sum of \$31,048.33 as alleged in Paragraph IV of the complaint.

Dated this 28 day of May, 1945.

JOS. I. McMULLEN,
LEO R. FRIEDMAN,
Attorneys for Plaintiffs. [198]
CHARLES H. CARR,
United States Attorney.
RONALD WALKER,
Assistant U. S. Attorney.
ROBERT E. WRIGHT,
Assistant U. S. Attorney.
Attorneys for Defendant.

[Endorsed]: Filed May 28, 1945. [199]

[Title of District Court and Cause.]

OPINION

This is an action under the Declaratory Judgment Statute, wherein plaintiffs seek to have this court hold that the Renegotiation Act (50 U.S.C.A., Appendix, Sec. 1191, in its original form to and including the amendments by the Act of July 14, 1943) is unconstitutional and unenforceable. The controversy arises over the fact that the War Department has determined that the plaintiffs' profits for the year 1942 were excessive, and in order to recapture said claimed excessive [200] profits has directed the defendant to withhold certain payments due the plaintiffs for the benefit of the United States in accordance with the provisions of said Renegotiation Act.

The United States intervened under the provisions of Sec. 401, Title 28 U.S.C.A. and has moved for a summary judgment on the grounds that the complaint fails to state a claim upon which relief can be granted. Plaintiffs admit that their cause of action is predicated solely upon the theory that said act is unconstitutional and if the court finds that said act is constitutional the motion should be granted.

A similar motion involving the constitutionality of said act was made in the case of *Lincoln Electric Co. v. Knox et al.*, 56 F. Supp. 308, before a three judge court, wherein the court denied the motion for summary judgment stating:

“The rule for summary judgment was, in our opinion, never intended to throw upon the court the burden of determining a case involving, on the one hand, a delicate question of law, and, on the other, complicated and controverted facts, without an adequate and proper hearing.”

The pleadings and affidavits submitted on the motion indicated to me that probably the factual situation could be fully developed on a pre-trial, consequently, I set the case for a pre-trial hearing at the same time the motion for summary judgment was set.

The facts as developed by the admissions of the pleadings and the admissions of the parties at the pre-trial hearing developed that the defendant, Douglas Aircraft Company, was a builder of airplanes for the government in the furtherance of the war effort; that the said defendant entered into numerous sub-contracts, in the form of work orders, with the plaintiffs for the manufacture, production and sale of mechanical fittings and parts, in accordance with specific plans and specifications furnished by the prime contractor to be used in the fabrication of airplanes built by it, in accordance therewith. The work orders usually were given and accepted by the plaintiffs on the strength of bids submitted to the prime contractor. The plaintiffs at all times knew that [201] the parts manufactured by them for the defendant were to be used in the

fabrication of airplanes for and at the expense of the government.

Following the adoption of the Renegotiation Act, through an exchange of letters, the plaintiffs agreed that all work orders received from the defendant would be subject to the provisions of said act, insofar as the same were required by law or by contract. Plaintiffs further agreed that the special conditions set forth in 42 and 42a would be applicable to all work orders received from defendant. The conditions contained in 42 and 42a amplified the procedure provided in said Renegotiation Act and provided further for the repayment of excess profits by sub-contractors in accordance with the provisions of said act. (See Exhibit A. and B. to answer admitted in evidence at said pre-trial.)

Thereafter, defendant continued to issue work orders to the plaintiffs and the plaintiffs continued to perform the same. Under the Renegotiation Act the War Department found that the plaintiffs' profits were excessive for the year 1942 and directed the defendant to withhold the amount of profits so found from amounts owing by defendant to plaintiffs under and by virtue of various subsequent work orders.

Upon the conclusion of the pre-trial hearing each party stipulated that the admissions made at said hearing would become a part of the record and that the motion for summary judgment and the final determination of the case should be submitted to the court for decision.

The plaintiffs contend that the said act is unconstitutional and therefore defendant is not justified in withholding payment pursuant to the directive of the War Department and have asked the court to so declare. It is admitted that the payments are withheld solely by reason of the withholding orders of the War Department in pursuance of the provisions of the said Renegotiation Act. The plaintiffs admit that if said act is constitutional they have no cause of action. All parties seek a ruling on the sole issue of constitutionality of said act and have directed their briefs to that end. [202]

On the other hand, the court is mindful that this issue should be avoided if the case can be determined on other grounds, notwithstanding the desires of the litigants. (*Arkansas Fuel Oil Co. v. Louisiana etc.*, 304 U.S. 197, 58 S.Ct. 832, 82 L.Ed. 1287; 16 C.J.S. p. 208; 6 R.C.L. p. 76 and 77; *Crowell v. Benson* 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598).

The burden rests upon the plaintiffs to establish the unconstitutionality of the act in question beyond a reasonable doubt. (*Nicol v. Ames*, 173 U.S. 509, 514, 19 S.Ct. 522, 43 L.Ed. 786). While I do not believe they have overcome this heavy burden, I feel that this case can finally be determined on other grounds, namely:

First—The correspondence between the parties constituted a contract between them. To me these letters clearly establish an agreement on behalf of the plaintiffs to be bound by said Renegotiation Act, and thereby said agreement became a part of every

work order notwithstanding anything therein to the contrary. The parties having thus contracted, it becomes immaterial whether the act is constitutional or not. (*Jones et al. v. Great Southern Fireproof Hotel*, 86 F. 370, 6th Cir.; *Stover v. Winston Bros. Co.* 55 P. (2d) 821, (Wash.); *U. S. v. San Francisco*, 310 U.S. 16, 60 S.Ct. 749, 84 L.Ed. 1050; *Interstate Consol. St. R. Co. v. Mass* 207 U.S. 79, 28 S. Ct. 26, 52 L. Ed. 111; *International & G. N. Ry. Co. v. Anderson County*, 246 U.S. 424, 38 S. Ct. 370, 62 L.Ed. 807).

The position of the plaintiffs is no different than if they had entered into a private contract with the defendant agreeing that all work orders would be filled and the charges therefore would include no excessive profits, leaving the determination of excessive profits solely and exclusively to arbitration by a third party. If such contract had been entered into, certainly the plaintiffs would not question its enforceability. In the case at bar the parties have agreed that the agencies of the government would have the authority to eliminate excessive profits in accordance with the provisions of the Renegotiation [203] Act. I see no difference between the two situations.

It would therefore appear that the parties, by their own contract, have eliminated the constitutional question.

Second—It is a recognized principle that a person may be estopped from asserting the unconstitutionality of an act. (*Pierce Oil Co. v. Phoenix*

Ref. Co., 259 U. S. 125, 128, 42 S. Ct. 440, 66 L. Ed. 855; *United Gas Co. v. R. R. Commission*, 278 U.S. 300, 49 S. Ct. 150, 73 L. Ed. 390; *Wall v. Parrott Silver & Copper Co.*, 244 U. S. 407, 37 S. Ct. 609, 61 L. Ed. 1229; *Com. of Internal Revenue v. Independent Life Ins. Co.*, 62 F. (2d) 1066, 1067; *Daniels v. Tearney*, 102 U.S. 415, 26 L. Ed. 187).

The correspondence heretofore referred to and the conduct of the Plaintiffs, in my opinion, creates an estoppel. The plaintiffs voluntarily executed their letter of November 14, 1942, at which time they indicated a willingness to be bound by the terms of the Renegotiation Act. They continued to accept work orders from the defendant. They knew and agreed that in performing such work in connection with the war effort any excessive profits were subject to recapture by and through the agencies of the government. After obtaining work orders and completing the same they are now attempting to avoid the effect of their agreement. It seems to me that by their own conduct they have waived their right to assert the unconstitutionality of the act in question and by the same token are estopped at this late date to retain any excessive profits. Having accepted the benefits of said work orders they are not now in a position to avoid the terms under which said work orders were issued and received.

Third—This action presents no justiciable controversy. Article I, §9, clause 7 of the Constitution provides as follows:

“No money shall be drawn from the Treasury, but in consequence of appropriations made by law. . .”

Congress in making appropriations has the power and authority not only to designate the purpose of the appropriation, but also the terms and conditions under which the executive department of the government may [204] expend such appropriations. Thus the War Department was required to make the Renegotiation Act a part of all its contracts.

The purpose of the appropriations, the terms and conditions under which said appropriations were made, is a matter solely in the hands of Congress and it is the plain and explicit duty of the executive branch of the government to comply with the same. Any attempt by the judicial branch of our government to interfere with the exclusive powers of Congress would be a plain invasion of the powers of said body conferred upon it by the Constitution of the United States.

Our judiciary has been exceedingly careful not to intrude upon the powers of the other two branches of the government and has often recognized its limitations in this respect.

In the case of *Decatur v. Paulding*, 39 U.S. 559 (14 Pet. 497), the court expressed itself as follows:

“* * * To permit an interference of the courts of justice with the accounts and affairs of the treasury, would soon sap its very foundations; money would not be drawn out according to its own rules, nor could the Secretary of the Treasury ever inform

Congress of the amount needed. Congress would, of necessity, be compelled to consult the court, not the Secretary, when making appropriations.”

In *Massachusetts v. Mellon*, 262 U. S. 447 at page 488, the following language is used:

“The functions of the government under our system are apportioned. To the legislative department has been committed the duty of making laws; to the executive the duty of executing them; and to the judiciary the duty of interpreting and applying them in cases properly brought before the courts. The general rule is that neither department may invade the province of the other and neither may control, direct or restrain the action of the other.
* * *”

Pertinent language is used in *Standard Oil of California v. U. S.*, 107 F. (2d) 402, 409 (9th Cir.) wherein it was stated:

“* * * The disposal of the public lands is not a subject over which the ‘judicial power’ of the United States is extended. It is a field in which the authority of the Congress is supreme. *Lee v. Johnson*, [25] 116 U.S. 48, 6 S. Ct. 249, 29 L. Ed. 570; Art. IV, §3, Clause 2 of the Constitution, U.S.C.A. * * *”

Again in *Stitzel-Weller Distillery v. Wickard*, 118 F. (2d) 19 at page 22, the court said:

“In the *Haskins Bros.* case we said [66 App. D. C. 178, 85 F. (2d) 681]:

“In the instant case it is therefore of no consequence whether the act under which the tax was collected be constitutional or unconstitutional. The fact that the tax has been collected and deposited in

the treasury by the collecting officials of the government renders the custodian of the fund impotent to withdraw the money and disburse it unless and until directed to do so by an act of Congress or until the United States shall submit to be sued to determine its disposition.

‘It is equally of no consequence that the bill alleges that the fund belongs to appellant and others similarly situated. It is not in the hands of the officers but in the treasury, and though earmarked as a special trust fund, has been mingled with the moneys of the United States. The purpose of the bill, therefore, is to coerce the United States, through their officers, to pay out money in the treasury as to which Congress has limited the power of withdrawal to the payment to the Philippine government. To permit this, would be to usurp the legislative function of appropriation, to substitute a court for the executive officers of the government, and to supplant by an order of court the duty and obligations imposed upon them by their oaths of office. It is therefore of no comment whether the United States have the use of this money as they do the ordinary revenues of the government or whether the money represents a trust fund created by Congress and earmarked for a specific purpose. In either case it is money in the Treasury of the United States as to which the United States had and have the power of control and disposition.’ ” (Underscoring supplied)

In *Gillies v. Webb et al*, 99 F. (2d) 585 (5th Cir.), the following may be found:

“On its face the constitutional point is without merit, for what is in question here is not the construction or validity of a statute, but of a contract voluntarily entered into with the Government. The fact that Congress authorized, indeed, required the inclusion in it of the clause in question as a condition to letting the work, is significant only upon the question of the authority of the executive officer to write the clause in. Without such authorization it may well be doubted that the contracting officer of the [206] Government would have had authority to insert it. Cf. *United States for Use and Benefit of Johnson v. Morley Construction Co.*, D.C. 17 F. Supp. 378, 388.”

Under the Public Contracts Act of June 30, 1936, Congress attached specific strings to certain appropriations analogous to those involved in the present action. Congress provided for the payment of minimum wages as determined by the Secretary of Labor to be paid by sellers of goods to the government. The constitutionality of this act was raised in the case of *Perkins v. Lukens Steel Co.*, 310 U.S. 113, 60 S. Ct. 869, 84 L. Ed. 1108. An injunction had been granted against the enforcement of the act and as a result the effectiveness of the same had been nullified for over a year. This provoked rather straightforward language from the Supreme Court, speaking through Mr. Justice Black, wherein certain lines of demarkation were drawn between the functions of the legislative and executive branches of the government and the judiciary. In plain and definite terms certain paths were forbidden for the

courts to travel. Among other things the court stated, starting at page 127:

“Like private individuals and businesses, the Government enjoys the unrestricted power to produce its own supplies, to determine those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases. Acting through its agents as it must of necessity, the Government may for the purpose of keeping its own house in order lay down guide posts by which its agents are to proceed in the procurement of supplies, and which create duties to the Government alone. It has done so in the Public Contracts Act. * * * Courts have never reviewed or supervised the administration of such an executive responsibility even where executive duties ‘require an interpretation of the law.’ Judicial restraint of those who administer the Government’s purchasing would constitute a break with settled judicial practice and a departure into fields hitherto wisely and happily apportioned by the genius of our polity to the administration of another branch of Government.” (Underscoring supplied.)

* * * *

“* * * In this legislation Congress did no more than instruct its agents who were selected and granted final authority to fix the terms [207] and conditions under which the Government will permit goods to be sold to it. The Secretary of Labor is under a duty to observe those instructions just as a purchasing agent of a private corporation must

observe those of his principal. In both instances prospective bidders for contracts derive no enforceable rights against the agent for an erroneous interpretation of the principal's authorization. For erroneous construction of his instructions, given for the sole benefit of the principal, the agent is responsible to his principal alone because his misconstruction violates no duty he owes to any but his principal. The Secretary's responsibility is to superior executive and legislative authority. Respondent's have no standing in court to enforce that responsibility or to represent the public's interest in the Secretary's compliance with the Act. That respondents sought to vindicate such a public right or interest is made apparent both by their prayer that the determination be suspended as to the entire steel industry and by the extent of the injunction granted."

* * * *

"The case before us makes it fitting to remember that 'The interference of the Courts with the performance of the ordinary duties of the executive departments of the Government, would be productive of nothing but mischief; and we are quite satisfied that such a power was never intended to be given to them.'" (Underscoring supplied.)

The plaintiffs being clearly within the purview of the Renegotiation Act and having agreed to be bound thereby are in no better position than the prime contractor. I am of the opinion that this case is dis-

tinguishable from *Coffman v. Breeze Corporations, Inc. et al.*, 323 U. S. 316, in that the case at bar deals with the expenditure of public funds. It would therefore appear that the plaintiffs' problems is one beyond the reach of this court.

Therefore, in view of the facts pleaded in the complaint and the surrounding facts brought out in the pre-trial of this case, the defendant is entitled to a judgment of dismissal. Defendant is directed to prepare forthwith findings in accordance with this opinion.

Dated: This 4 day of June, 1945.

BEN HARRISON,

Judge. [208]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for hearing before the court without a jury on May 28, 1945, on the motion of defendant and intervenor for a summary judgment and on the counter motion of plaintiffs for a judgment in their favor, and the court having considered the pleadings, the motion filed by the defendant, and the intervenor, the United States of America, and the affidavits filed in support thereof, and having considered the motions and stipulations made and entered into at a pretrial hearing on said date and having considered the motion of plaintiffs aforesaid

and the affidavit filed in opposition to defendant's motion and all of the pleadings on file herein, and having taken the case under advisement, now finds the facts and states the conclusions of law as follows: [209]

I.

FINDINGS OF FACT

1. That at all times herein mentioned each of the plaintiffs was a citizen of the State of California, a citizen and inhabitant of the County of Los Angeles in the District aforesaid, and that the business of the plaintiffs was being operated and conducted in said county of Los Angeles; that defendant was a corporation organized and existing under and by virtue of the laws of the State of Delaware and doing business within the Central Division of this District; and that the matter in controversy in this suit exceeds the sum or value of \$3,000.00, exclusive of interest and costs.

2. That at all times herein mentioned defendant was engaged as a prime contractor with the Government of the United States in manufacturing airplanes for the Government in furtherance of the war effort; that plaintiffs were engaged in the manufacture of airplane parts for the defendant and others devoting approximately 100 per cent of its capacity to the production of war materials and obtaining the materials used by them in said manufacture through priorities.

3. That the defendant during the year 1942 entered into numerous subcontracts in the form of

purchase orders with the plaintiffs for the manufacture, production and sale of mechanical fittings and parts in accordance with blueprints and specifications furnished by defendant, which purchase orders were given to and accepted by plaintiffs on the strength of bids submitted to defendant by plaintiffs as the result of competitive bidding in which plaintiffs and other firms and corporations participated; and that plaintiffs at all times knew that the parts manufactured by them for the defendant were to be used in the fabrication of airplanes for and at the expense of the Government.

4. That on or about November 14, 1942, plaintiffs addressed a letter to defendant (Exhibit B attached to defendant's answer) in the words and figures following, to-wit: [210]

“November 14, 1942

“Douglas Aircraft Company, Inc.

Materiel Division

P. O. Box 9337, Station S.

Los Angeles, California

Subject: Renegotiation Clause

Gentlemen:

We have received your letter of September 14, 1942, on the subject of renegotiation.

We hereby agree that Special Conditions 42 and 42A printed on the reverse side hereof shall be applicable to all purchase orders which you issue to us under Army and Navy contracts respectively; provided, however, that this agreement shall cover

only purchase orders in which you are required by law or by contract to insert such Special Conditions, and shall continue only so long as such requirement may be effective.

Yours sincerely,

MANLOVE & SPAULDING
MFG. CO.

(signed) By R. E. SPAULDING

Partner

That said Special Conditions 42 and 42A were and are in the words and figures following:

“Special Condition No. 42—Renegotiation under
Army Contracts

“(1) Upon the written demand of the Secretary, at such period or periods when, in the judgment of the Secretary, the profits accruing to Seller under this contract can be determined with reasonable certainty, the Secretary and Seller will renegotiate the contract price to eliminate therefrom any amount found as a result of such renegotiation to represent excessive profits. The demand of the Secretary shall fix a place for renegotiation and a time for the commencement thereof not later than one year after the date of completion or [211] termination of this contract as found by the Secretary.

“(2) Seller will furnish to the Secretary such statements of actual costs of production and such other financial statements, at such times and in such form and detail, as the Secretary may prescribe, and will permit such audits and inspections of its books and records as the Secretary may request.

“(3) Any amount of the contract price found as a result of such renegotiation to represent excessive profits shall, as directed by the Secretary, (a) be deducted by Buyer from payments otherwise due to Seller under this contract; or (b) be paid by Seller directly to the Government.

“(4) Seller agrees that Buyer shall not be liable to Seller for or on account of any amount paid to the Government by Seller or deducted by Buyer from payments otherwise due under this contract, pursuant to directions from the Secretary in accordance with the provisions of this Article. Under its contract with the Government, Buyer is obligated to pay or credit to the Government all amounts withheld by it from Seller hereunder.

“(5) As used in this Article:

(a) The term ‘Secretary’ means the Secretary of War or any duly authorized representative of the Secretary, including the contracting officer;

(b) The terms ‘renegotiate’ and ‘renegotiation’ have the same meaning as in Section 403(b) of the Sixth Supplemental National Defense Appropriation Act, 1942;

(c) The term ‘this contract’ means this contract as modified from time to time.

“(6) Seller agrees (a) to include in each fixed-price or [212] lump-sum subcontract hereunder for an amount in excess of \$100,000 the foregoing sections (1) to (5) inclusive, and (b) to make no subdivisions of any contract or subcontract for the purpose of evading the provisions of this section, and (c) to repay to the Government the amount of any

reduction in the contract price of any such subcontract which results from renegotiation thereof by the Secretary and which the Secretary directs the Seller to withhold from payments otherwise due under such subcontract and actually unpaid at the time the Seller receives such direction.

“The term ‘subcontract’ includes any purchase order from or any agreement with Seller (i) to perform all or any part of the work to be done under this contract, or to make or furnish all or any part of any articles or structures covered by this contract, (ii) to supply any services required directly for the production of any articles or structures covered by this contract, or any component part thereof, not including services for the general operation of Seller’s plant or business, (iii) to make or furnish any articles destined to become a component part of any article covered by this contract, or (iv) to make or furnish any articles acquired by Seller primarily for the performance of this contract, or this contract and any other contract with the United States. The term ‘articles’ includes any supplies, materials, machinery, equipment or other personal property.”

“Special Condition No. 42A. Renegotiation under
Navy Contracts

“(a) At any time, when in the judgment of the Secretary, the profits accruing to Seller under this Purchase Order can be determined with reasonable certainty, the Secretary and Seller, upon the written demand of the Secretary, will [213] renegotiate

the price with a view to eliminating such profits as are found as a result of such negotiation to be excessive.

“(b) In the event that such renegotiation results in a reduction of the price, the amount of such reduction shall, as may be directed by the Secretary, be deducted by Buyer from payments to Seller under this Purchase Order; or be paid by Seller directly to the Government; or be repaid by Seller to Buyer.

“(c) Seller agrees that Buyer shall not be liable to Seller for or on account of any amount repaid to Buyer or paid to the Government by Seller or deducted by Buyer from payments to Seller pursuant to directions from the Secretary in accordance with the provisions hereof. Under its contract with the Government, Buyer is obligated to pay or credit to the Government all amounts repaid by or withheld from Seller hereunder.

“(d) The term ‘Secretary’ as used herein means the Secretary of the Navy and his duly authorized representatives.”

Thereafter defendant continued to issue such orders to plaintiffs and plaintiffs continued to perform the same.

5. That on February 2, 1944, Robert P. Patterson, Under Secretary of War, acting pursuant to the Renegotiation Act, as amended, duly made a unilateral order (in the words and figures set out in paragraph V(d) of the complaint) determining that \$110,000.00 of the profits realized by plaintiff

during its fiscal year ending December 31, 1942, under its subcontracts subject to renegotiation pursuant to said Act are excessive; and thereafter on May 1, 1944, said Robert P. Patterson, Under Secretary of War, duly directed defendant by an order in the words and figures set out in paragraph V(e) of the complaint to withhold for the account of the United States any and all amounts (not in excess of \$110,000.00 in the aggregate) otherwise due or which shall become due from defendant to [214] plaintiffs. That pursuant to said direction defendant withheld from plaintiffs for the account of the United States the sum of \$27,580.80 for the recovery of which amount this suit was instituted by plaintiffs. It is admitted that defendant's refusal to pay plaintiffs the amount so withheld is based solely on the withholding order issued by the Under Secretary of War and plaintiffs admit that if the Renegotiation Act is constitutional they have no cause of action. Defendant and intervenor admit that if the Renegotiation Act is unconstitutional, plaintiffs should recover and judgment should be for the plaintiffs.

6. That all of the business done by plaintiffs during the fiscal year ending December 31, 1942, was with private firms, corporations and individuals and none of such business was done on prime contracts with the United States of America. All the individual orders and contracts of plaintiffs for the year 1942 varied in amounts from 60 cents to \$8,000.00 each.

7. That plaintiffs have not filed a petition for redetermination of its excessive profits in the Tax Court of the United States and the time for filing that petition has expired.

8. That there is no genuine issue between the parties as to any material fact and defendant is entitled to judgment as a matter of law.

9. That on September 12, 1944, the Court certified to the Attorney General, pursuant to the Act of August 24, 1943, 28 U.S.C.A. 401, the fact that the constitutionality of the Renegotiation Act, an Act of Congress affecting the public interest, was drawn in question herein and thereafter and on December 18, 1944, an order was made allowing intervention by the United States and directing that the United States be made a party to the cause.

10. That the amounts sued for by plaintiffs in the complaint herein represented work done by plaintiffs for defendant from the 1st day of March, 1944, to and including the 31st day of July, 1944, and did not comprise any work done by plaintiffs for defendant during the fiscal year ending December 31, 1942, and the amount thereof was and is in the stipulated and agreed sum of \$27,580.80.

II.

CONCLUSIONS OF LAW

1. The agreement between the parties with reference to incorporation in purchase orders of Special Conditions 42 and 42A establishes an agreement on behalf of the plaintiffs to be bound by the Re-

negotiation Act and thereby said agreement became a part of every purchase order, notwithstanding anything therein to the contrary; the parties having thus contracted, it becomes immaterial whether the Act is constitutional or not. Therefore, the parties by their own contract have eliminated the constitutional question.

2. The agreement between the parties with reference to incorporation in purchase orders of Special Conditions 42 and 42A, the conduct of plaintiffs in continuing thereafter to accept purchase orders from the defendant and to perform the same creates an estoppel and thereby plaintiffs have waived their right to assert the unconstitutionality of the Renegotiation Act and are estopped at this late date to retain any excessive profits. Having accepted the benefits of said purchase orders, they are not now in a position to avoid the terms under which said purchase orders were issued and received.

3. This action presents no justiciable controversy for the reason that this Court has no power to interfere with the exercise by the Congress of its constitutional power to prescribe and define the terms and conditions under which the Executive Department of the Government may expend moneys appropriated by the Congress.

4. The complaint fails to state a claim upon which relief can be granted.

5. That defendant is entitled to judgment.

It Is Ordered that judgment shall be entered in conformity herewith.

Dated: July 30, 1945.

BEN HARRISON

Judge of the United States
District Court

[Endorsed]: Filed July 30, 1945. [216]

In the District Court of the United States In and
For the Southern District of California, Cen-
tral Division

No. 3806-BH Civil

R. E. SPAULDING, L. B. MANLOVE and P. M.
MANLOVE, co-partners doing business under
the firm name and style of MANLOVE &
SPAULDING MFG. CO.,

Plaintiffs,

v.

DOUGLAS AIRCRAFT COMPANY, Inc.,
a corporation,

Defendant.

JUDGMENT

This cause came on regularly for trial before the Court, without a jury, on May 28, 1945, and in conformity with the Court's Findings of Fact and Conclusions of Law, it is

Ordered and Adjudged that plaintiffs take nothing by their suit; and that defendant, Douglas Aircraft Company, Inc., do have and recover from the

plaintiffs its costs and charges in this behalf expended and have execution therefor.

Dated: July 30, 1945.

BEN HARRISON

Judge of the United States
District Court.

Judgment entered July 30, 1945. Docketed July 30, 1945. Book C.O. #34, Page 218.

EDMUND L. SMITH

Clerk

By [Illegible]

Deputy

[Endorsed]: Filed July 30, 1945. [217]

In the District Court of the United States For the
Southern District of California, Central Division

Civil No. 3806-BH

R. E. SPAULDING, L. B. MANLOVE and P. M.
MANLOVE, co-partners doing business under
the firm name and style of MANLOVE &
SPAULDING MFG. CO.,

Plaintiffs,

vs.

DOUGLAS AIRCRAFT COMPANY, Inc.,
a corporation,

Defendant.

UNITED STATES OF AMERICA,

Intervenor.

NOTICE OF APPEAL

Notice is hereby given that plaintiffs above named do herewith and hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit, from the final judgment and order made and rendered and filed in the above entitled Court and cause on the 30th day of July, 1945, in favor of defendant and against plaintiffs and from the whole of said judgment and order.

Dated: August 1st, 1945.

JOS. I. McMULLEN

LEO R. FRIEDMAN

Attorneys for Plaintiffs [218]

Copy of the foregoing received this 1st day of August, 1945.

CHARLES H. CARR

United States Attorney

ROBERT E. WRIGHT

Assistant United States

Attorney

[Endorsed]: Filed Aug. 1, 1945. [219]

[Title of District Court and Cause.]

STATEMENT OF POINTS ON WHICH AP-
PELLANTS INTEND TO RELY ON AP-
PEAL

Come now the plaintiffs above named and pursuant to the provisions of Subdivision d of Rule 75 of the Federal Rules of Civil Procedure for the District Courts of the United States, file this their designation of the points on which they intend to rely on their appeal herein to the United States Circuit Court of Appeals for the Ninth Circuit, and specify and designate said points as follows, to wit:

1. That the said District Court erred in granting the motion of defendants for a summary judgment.
2. That the said District Court erred in denying the motion of plaintiffs for judgment.
3. That the said District Court erred in rendering judgment for defendants.

4. That the District Court erred in holding that the complaint of plaintiffs failed to state a claim upon which relief could be granted.

5. That the District Court erred in failing and refusing to pass upon the constitutionality of the Federal Renegotiation Act.

6. That the District Court erred in holding that there was no genuine issue between the parties as to any material fact and that defendant is entitled to judgment as a matter of law.

7. That the District Court erred in holding that plaintiffs by their own contract had eliminated the constitutional question involved in the case.

8. That the District Court erred in holding that plaintiffs' actions created an estoppel which operated to prevent them from asserting the unconstitutionality of the Renegotiation Act.

9. That the District Court erred in holding that as a result of the letters and special conditions 42 and 42a, as set forth in "Exhibit B" attached to the answer of defendants, the plaintiffs agreed to the renegotiation of any or all of their contracts for the fiscal year 1942, or for the renegotiation of any contracts during said fiscal year.

10. That the District Court erred in not holding that as the result of the matters and things set forth in [221] "Exhibit B" attached to the answer of defendants plaintiffs only agreed to the renegotiation of contracts entered into between plaintiffs and defendant where any such contract amounted to the sum of \$100,000 or more.

11. That the District Court erred in not holding that the Federal Renegotiation Act was and is unconstitutional.

12. That the pleadings and papers on file and the stipulations entered into at the hearing of the cause established the right of plaintiffs to judgment and the right of plaintiffs to a declaratory judgment holding and declaring that the Federal Renegotiation Act is unconstitutional, all of which appears from the reporter's transcript of the proceedings at the hearing of the cause on file herein and the pleadings and affidavits on file herein following appeals.

Dated: August 1st, 1945.

JOS. I. McMULLEN

LEO R. FRIEDMAN

Attorneys for Plaintiff

Copy of the foregoing received this 1st day of August, 1945.

CHARLES H. CARR

United States Attorney

ROBERT E. WRIGHT

Assistant United States
Attorney

[Endorsed]: Filed Aug. 1, 1945. [222]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL

Come now plaintiffs above named and file this their designation of the portions of the record, proceedings and evidence to be contained in the record on their appeal herein to the United States Circuit Court of Appeals for the Ninth Circuit:

1. The complaint.
2. Certificate of the District Judge, dated September 12, 1944. [223]
3. Answer of defendants.
4. Order allowing intervention by the United States.
5. Answer of the United States.
6. Motion for summary judgment.
7. Stipulation of May 28, 1945, as to the amount due from defendant to plaintiffs.
8. The reporter's transcript of the proceedings on the hearing and submission of the cause.
9. Affidavit of Robert P. Patterson.
10. Affidavit of H. Struve Hensel.
11. Affidavit of R. E. Spaulding.
12. Opinion of the United States District Judge.
13. Findings of fact and conclusions of law.
14. The judgment.
15. The notice of appeal.
16. Statement of points on which appellants intend to rely on appeal.
17. This designation of contents of record.

Dated: August 1st, 1945.

JOS. I. McMULLEN
LEO R. FRIEDMAN
Attorneys for Plaintiffs

Copy of the foregoing received this 1st day of August, 1945.

CHARLES H. CARR
United States Attorney.
ROBERT E. WRIGHT
Assistant United States
Attorney

[Endorsed]: Filed Aug. 1, 1945. [24]

[Title of District Court and Cause.]

DESIGNATION OF ADDITIONAL CON-
TENTS OF RECORD ON APPEAL

Come now the defendant and intervenor above named and designate additional portions of the record, proceedings and evidence to be included in the Record on Appeal herein to the United States Circuit Court of Appeals for the Ninth Circuit:

1. Motion of the United States for Leave to Intervene; [225]
2. Notice of Motion of the United States for Leave to Intervene;
3. Certificate of B. D. Gamble, Clerk of the Tax Court of the United States.

Dated August 7, 1945.

FRANCIS M. SHEA,

Assistant Attorney General

CHARLES H. CARR,

United States Attorney

RONALD WALKER,

Assistant United States

Attorney

ROBERT E. WRIGHT,

Assistant United States

Attorney

Attorneys for Defendant and

Intervenor.

Copy received August 7, 1945.

JOS. I. McMULLEN

L. R. FRIEDMAN

Attorneys for Plaintiffs

[Endorsed]: Filed Aug. 7, 1945. [226]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 226 inclusive contain full, true and correct copies of Complaint for Declaratory Judgment and Money Judgment; Certificate; Answer; Notice of Motion for Leave to Intervene; Response to Certification and Motion by

United States to Intervene; Order Allowing Intervention by United States; Answer of the United States; Notice of Motion for Summary Judgment; Motion for Summary Judgment; Affidavit of Robert P. Patterson in Support of Motion for Summary Judgment; Affidavit of H. Struve Hensel in Support of Motion for Summary Judgment; Affidavit of R. E. Spaulding in Opposition to Defendant's Motion for Summary Judgment; Certificate of Clerk of the Tax Court of the United States; Stipulation; Opinion; Findings of Fact and Conclusions of Law; Judgment; Notice of Appeal; Statement of Points on Appeal; Designation of Contents of Record on Appeal and Designation of Additional Contents of Record on Appeal which, together with copy of Reporter's Transcript, transmitted herewith, constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing, comparing, correcting and certifying the foregoing record amount to \$54.90 which sum has been paid to me by appellants.

Witness my hand and the seal of said District Court this 31st day of August, 1945.

[Seal]

EDMUND L. SMITH,

Clerk

By THEODORE HOCKE,
Chief Deputy Clerk

In the District Court of the United States in and
for the Southern District of California, Central
Division

Before the Honorable Ben Harrison.

No. 3806-BH—Civil

R. E. SPAULDING, L. B. MANLOVE and P. M.
MANLOVE, Co-partners, etc.,
Plaintiffs,

vs.

DOUGLAS AIRCRAFT COMPANY, INC., a
Corporation,
Defendant.

UNITED STATES OF AMERICA,
Intervenor.

REPORTER'S TRANSCRIPT OF
PROCEEDINGS

Los Angeles, California
May 28, 1945

Appearances:

For the Plaintiffs: Joseph I. McMullen,
Esq., and Leo. R. Friendman, Esq., 935 Russ
Building, San Francisco, 4, California.

For the Defendant, Douglas Aircraft Company, Inc.: Charles H. Carr, Esq., United States Attorney, by Ronald Walker, Esq., and Robert E. Wright, Esq., Assistant United States Attorneys.

For the Intervenor United States of America: Walker Lowry, Esq., Attorney, Department of Justice, Washington, D. C. [1*]

The Clerk: 3806-BH Civil, R. E. Spaulding, and others, versus Douglas Aircraft Company and the United States of America, Intervenor.

Mr. Friedman: Ready for the plaintiffs.

The Clerk: Pre-trial hearing and motion of defendant for summary judgment.

Mr. Wright: Ready for the defendants, your Honor.

The Court: Gentlemen, I have put this down for a pre-trial hearing at the same time, due to a three-judge court decision by the District Court of the District of Columbia in a summary proceeding in a case of this character. The fact is they denied it. While maybe you can distinguish the case—the case I am referring to is *Lincoln Electric Company v. Knox*, 56 Fed. Supp. 308—I felt that there was probably no substantial difference between the parties as to the factual situation, and that probably through a pre-trial we could get a background, so that when the courts finally settle this they will not turn it off on a tangent and will be able to pass on the questions involved in this case. I might say that I tried a criminal case a year or so ago that involved one of these subcontracts, and in that case there was no dispute as to the procedure of the two concerns, the methods of business of the two con-

*Page numbering appearing at top of page of original certified Transcript.

cerns, and I thought perhaps the situation might be very similar in this case. [2]

Mr. Lowry: Your Honor, I think I could make a short preliminary statement about the facts in this case, if that will be helpful.

The Court: Let me ask some questions in the first place. I think I can bring out my points by asking some questions or making a statement as to the method that was followed in the other case, which also involved making parts for Douglas.

I assume that there is no dispute that Douglas has been engaged in the manufacture of airplanes for the government in pursuance of the war effort.

Mr. Friedman: No, there is no question about that.

The Court: And that the plaintiff in this case was making parts that were being used in the assembling of those planes.

Mr. Lowry: That is so.

Mr. Friedman: I think in the main that is true.

The Court: That is, I assume that they were also making them, perhaps, for other airplane manufacturers.

Mr. Friedman: That is true.

The Court: And you can answer this question. I don't know whether it is material or not. But probably the plaintiff was almost one hundred per cent devoted to war effort.

Mr. Friedman: I would say the greater part.

The Court: Approximately. And was the plaintiff engaged in this kind of work prior to its work

in war effort? [3] It was not what we call, in the slang expression, "a war baby"?

Mr. McMullen: No, it is not "a war baby."

Mr. Friedman: No.

The Court: But that it did, in fact, expand its facilities, I assume, to take care of its war efforts.

Mr. Friedman: I think that is correct.

The Court: And that the materials used in the parts were obtained through priorities.

Mr. Friedman: That is correct.

The Court: And any additional equipment that they needed to make the various parts, of course, had to be obtained by the obtaining of priorities.

I was going to ask as to the statement in here that the contracts or the work orders, as they are referred to, were based upon bids submitted by the plaintiff to the defendant.

Mr. McMullen: Yes, that is correct, sir.

Mr. Lowry: We understand, your Honor, that is true in the main; that, as far as all major releases of work were concerned, there were bids submitted. But occasionally after the original bid was submitted——

The Court: Well, that is a minor part.

Mr. Lowry: That is right.

The Court: When the bids were asked for and submitted, that Douglas would submit blue-prints—— [4]

Mr. Lowry: That is so, your Honor.

The Court: ——covering the parts that they wanted a bid on.

Mr. Lowry: In all instances.

Mr. Friedman: Yes.

The Court: And that the work was performed in accordance with those blueprints.

Mr. Lowry: That is so.

Mr. Friedman: That is right, and the bids based thereon.

The Court: Yes.

Mr. McMullen: And the order was awarded on the lowest bid. They were the lowest bidders; that is the reason they got the business. Those orders were put out to several manufacturers, you see, your Honor, and the bid is awarded to the lowest bidder.

The Court: Well, we would certainly assume they would be.

Mr. Lowry: Unless there was some other consideration, I assume, your Honor.

The Court: Yes.

Mr. Lowry: Douglas could, of course, award the bid to any one that they saw fit.

The Court: Yes. Then during the progress of the work it was being constantly inspected by government inspectors, was it not?

Mr. McMullen: No. [5]

Mr. Lowry: Not at the Manlove plant, your Honor. At the Manlove plant the inspection was by Douglas.

The Court: After the delivery of the parts——

Mr. Lowry: No.

The Court: ——or during the course of the making of the parts?

Mr. Lowry: Well, I am not sure, but I understand——

Mr. McMullen: As a rule at the Douglas plant after they were delivered.

The Court: They were accepted or rejected.

Mr. Lowry: Yes. And the army inspected the parts again when they were delivered to Douglas, and that inspection took place at the Douglas plant.

The Court: In the other case I had they had inspectors at the plant all the time.

Were the accounts and statements that were rendered to Douglas audited by agencies of the government at the plant?

Mr. Lowry: The army audits Douglas' books because Douglas is a cost-plus contractor.

The Court: I know, but did they audit——

Mr. McMullen: ——the plaintiff's books? No.

Mr. Friedman: No.

The Court: They never at any time made any examination prior to the renegotiation of the statements as to the correctness at the plant?

Mr. Friedman: No. [6]

Mr. McMullen: No. As I understand it, the government as an active factor never entered the plaintiff's plant, either for the purpose of auditing books or inspecting the bills. Is that correct, Mr. Lowry?

Mr. Lowry: I think that is so.

Mr. McMullen: In other words, the government did all of its auditing and supervision with its prime contractor.

The Court: Now may I ask was Douglas, the

prime contractor, working on a definite contract, or was it a cost-plus contract?

Mr. Lowry: Cost-plus.

The Court: Was there any knowledge on the part of the defendant to that effect?

Mr. Lowry: On the part of the plaintiff?

The Court: I mean on the part of the plaintiff.

Mr. McMullen: No.

Mr. Lowry: I assume so, yes.

Mr. McMullen: He had no knowledge except just hearsay, what you hear. But there is nothing appearing in the orders or correspondence to indicate it.

The Court: I know, but wasn't it a matter of general knowledge among all these subcontractors that the airplanes were built on a cost-plus basis?

Mr. Lowry: It must be so, your Honor.

Mr. Friedman: I wouldn't know about that.

Mr. McMullen: I wouldn't say so. I don't think so. [7]

Mr. Friedman: I don't know about that.

The Court: I don't know whether there are two answers or whether they are both joined in one answer, but there are two letters that are pleaded in the answer. Is there any dispute as to the correspondence?

Mr. McMullen: You mean the two letters set up in the affidavit of the plaintiffs?

The Court: No, in the answer.

Mr. Lowry: In Douglas' answer, Mr. Friedman.

The Court: It is the answer of the Douglas Company. There is a letter from Douglas, a form

letter, I assume, to the plaintiff; and the plaintiff responded. You have read the answer, haven't you?

Mr. McMullen: Yes, your Honor.

The Court: Here it is right here, gentlemen.

Mr. Lowry: I have a copy, your Honor.

Mr. Friedman: Yes, they were sent and signed.

The Court: It is stipulated, then, that those letters pleaded in the answer were actually sent, and the response made as indicated?

Mr. Friedman: That is correct.

The Court: And, of course, the fact that it was government work and plaintiff knew that the Federal Government was paying Douglas for the airplanes.

Mr. Friedman: There is no question about that.

The Court: Now, gentlemen, I have—— [8]

Mr. Friedman: May I interrupt your Honor while we are clearing up these factual situations? Your Honor probably has noted that there was a differential in the complaint and the answer as to the amount of money involved. We have agreed and signed a stipulation this morning that the exact amount involved is \$27,580.80. So that removes that item.

The Court: That fixes the amount.

Mr. Lowry: May this stipulation be considered by the court?

The Court: It may be filed.

Mr. Lowry: Your Honor, in that connection I have a certificate from the clerk of the Tax Court of the United States which says, in effect,

that he has examined the files of his court and finds that this plaintiff has not filed in that court any petition for redetermination of its excess profits. I think that is agreed between us, but I would like to have this certificate considered as part of the record.

Mr. Friedman: We have no objection to it. It is a fact.

The Court: Is there anything else? Of course, the answer admits everything but the unconstitutionality.

Mr. Friedman: Yes.

The Court: That is the only issue raised by the pleadings. Are there any other facts that either one of you gentlemen think should be clarified?

Mr. Friedman: There is only one thing more. As your [9] Honor will recall, in the affidavit filed by plaintiffs we set up two letters, one sent to the Secretary of War, and the reply, requesting information as to the facts and figures and data on which the unilateral determination of excessive profits was made. The answer stated that it was against the policy of the Department to disclose that information. There is no question as to those letters, Mr. Lowry?

Mr. Lowry: No. For the purposes of this motion it is conceded the letters were sent and the answer made.

The Court: The affidavits are not in conflict, as I view them. Each one is setting forth his own cause in the affidavits, and there have been no coun-

ter affidavits. There is no dispute as to that anyhow, so far as this motion is concerned, so that part is cleared up.

Now, gentlemen, I have pretty nearly worn out your briefs, and in hearing arguments in this case I do not care to hear a repetition of the things that I have been reading.

Mr. Friedman: While your Honor is referring to briefs, I have here a ten-page typewritten document, which comments, merely comments, on some of the cases referred to in the government's reply brief. I ask leave to file that. I have given Mr. Lowry a copy of it.

The Court: You are not going to give me something more to read, are you?

Mr. Friedman: It is not very long and you probably are conversant with the cases. There is probably nothing in this [10] closing brief your Honor doesn't know, anyway.

The Court: I don't know how you gentlemen desire to handle this argument. This court has more or less been in the habit of doing most of the arguing itself and not giving counsel much of an opportunity in that respect. I have a number of memoranda of my own and I would like to have some things clarified in my own mind.

Mr. Friedman: May I make this suggestion? I discussed with Mr. Lowry this morning the matter of the procedure in this case, and it was my impression that, as long as all the facts have been agreed upon—at that time, of course, we felt prob-

ably the only thing involved was the amount, because we have agreed on everything else—I personally can't see why this matter cannot be submitted to the court on its merits, rather than on the motion for summary judgment.

Mr. Lowry: Your Honor, we prefer to handle it on the motion for summary judgment. We would like to use this case not only as a precedent as far as the substantive features of this debate are concerned, but——

The Court: Well, I am afraid that unless you gentlemen can convince me to the contrary that I am not going to make either one of you happy.

Mr. Lowry: In any event we would like it to go along in the regular orderly procedure on the motion for summary judgment. That is the only thing that is before the court, as I understand it.

The Court: Well, you have raised the question and, of course, have raised it on the motion for summary judgment, but, after all, it is the responsibility of this court to make a final determination, if I can, and the thought I had in mind was that I would take the motion together with the information obtained here so that the record will be complete and any reviewing court will have a background, if they need it.

Mr. Lowry: That is satisfactory to us, your Honor.

The Court: In that way we will not have it go off on a tangent, that is, send it back, because, as was said in the Knox case, there should be a proper and adequate hearing.

Mr. Lowry: Your Honor, we think the way to handle this is to consider it on the motion for summary judgment and to consider that the materials which have been agreed to here this morning be a part of the record on the motion.

The Court: That has the same effect.

Mr. Lowry: I think so.

Mr. Friedman: Well, with this exception. My idea was that these facts having been agreed upon, there being no other factual issue before the court, the court could hear the motion for summary judgment and then we could submit the entire matter, the motion and the case on the merits. In that way we get a final determination rather than just an interlocutory ruling.

The Court: Regarding the question of constitutionality, [12] if the reviewing court passed on it they would pass on it, probably, strictly on the motion. Of course, this could have been raised on a motion to dismiss, as far as that is concerned, and there would have been strictly a constitutional question involved. But you gentlemen both appreciate and realize that it is a delicate matter for a trial court to pass upon the constitutionality of an Act of Congress. Sometimes I feel it is presumptuous unless we are convinced beyond a reasonable doubt that the Act is unconstitutional; it is a one-man court passing upon it, while the reviewing courts have the advantage of the consultation of minds; and, of course, the finality of reviewing courts is more effective and it is always, as I said

before, a delicate question for a district judge to take it upon himself to hold an Act unconstitutional if there is any way that he can avoid doing it.

Mr. Friedman: I understand that, your Honor. I realize it is a great responsibility and it is a delicate question and that, so far as the trial court is concerned, unless the constitutionality is clear it is probably better to adopt some procedure whereby that is left to a higher court. And that comes right back to what I am saying. As far as I know, a motion for summary judgment, unless granted, is not appealable. That is why I suggested that in this matter we come to some——

The Court: Why can't we agree to this? It seems to [13] me, counsel, the best way is to submit it so that either side will have a right to appeal when we get through.

Mr. Lowry: If that is going to be done, your Honor, I think the way it should be handled is for Mr. Friedman to make a cross-motion for judgment. I, at least, feel a little uncertain when things aren't done in the procedures that the court has established.

Mr. Friedman: Isn't this a proper procedure; if your Honor said, "All right, I will set this down for trial tomorrow——"

The Court: You can make it now if it is satisfactory to counsel.

Mr. Lowry: All right, make it.

The Court: An oral motion for judgment.

Mr. Friedman: Very well, your Honor. At this

time, then, on behalf of the plaintiffs, and in view of the fact that as a result of the pre-trial conference all of the factual issues have been settled and agreed upon, I move at this time that judgment be entered in favor of the plaintiff for the amount set forth in the stipulation as to the amount due, upon the ground that the Act is unconstitutional and, therefore, the orders which the defendant sets up as justification for not paying the amount admittedly due are without any force or effect, because the Renegotiation Act is unconstitutional and void because the unilateral order of determination runs counter to the Constitution and runs [14] counter to the Act and, therefore, the withholding order is without any vitality or effect.

Mr. Lowry: Your Honor, may it be agreed that our briefs and our affidavits are submitted in opposition to the motion that counsel has just made?

Mr. Friedman: I will add to my motion that all the papers, records, pleadings and stipulations now on file before the court be considered as part of the motion.

The Court: Satisfactory to counsel?

Mr. Lowry: That is satisfactory, your Honor.

The Court: That brings it right down to where a determination will place you both in a position where either one of you, if you so desire, can appeal.

Mr. Friedman: That was my idea in the matter. And may I add this, that the defendants and government raise no objection to the manner or form in which the motion is presented; that is, waive customary notice of presentation of such motions?

Mr. Lowry: We have no objection.

Mr. Friedman: And there is no objection to its being made orally, as suggested by the court?

Mr. Lowry: We have no objection to the form of the motion.

Your Honor, may I make one or two suggestions about your Honor's suggestion as to how this case or this argument might be handled? [15]

The Court: I will listen to suggestions, but that does not mean that I will follow them.

Mr. Lowry: Your Honor, it has been pointed out to me that as far as I am concerned I am here on behalf of the government and not on behalf of Douglas, and I suppose Mr. Wright ought to join in what I have said on behalf of Douglas.

Mr. Wright: I do that, your Honor. Just to keep the record straight.

Mr. Lowry: Now my suggestion as to the way of handling this, your Honor. First of all I would like to add one or two facts to what has already been stated, I am sure there is no dispute about them, and then, if it is satisfactory, your Honor, I would like to start over this case, and I would be glad and indeed anxious to have your Honor interrupt me at any point when it seems to you I have reached something that is debatable, and I will try not to repeat the things I have said in the briefs, at least not at any length, but I would like, if I may, to have an opportunity to present the all-around picture, so to speak, so that we can get these arguments in their proper context; and I suggest

that that would be as expeditious a manner of handling this as any other.

The Court: Gentlemen, there are certain features of this case that I want clarified, and I want to hear from both counsel on them. It is a well-recognized principle of law that the court should determine a case, if it can, without passing upon the constitutionality of an Act; the court [16] should avoid that. Consequently I have made some study of this picture to ascertain whether it could be disposed of without the necessity of passing upon the constitutionality. I do not know what more you gentlemen can say on the constitutionality of this Act than has already been presented in these briefs, except to hear yourselves expound. I believe that I have a fair grasp of the picture. But I would like to know from the plaintiff, in view of the letters attached to the answer, and which they have stipulated to, why they haven't entered into a contract which eliminates the question of constitutionality.

Mr. Friedman: I think there are several answers to that, your Honor. In the first place, if the Act is unconstitutional no stipulation can breathe vitality into that Act.

The Court: Counsel, have you any authority for that? The authorities that I have from the Supreme Court of the United States have clearly held that notwithstanding an Act is unconstitutional, that by contracting to comply with it that you are out.

Mr. Friedman: Well, that might be——

The Court: In other words, isn't the effect of these letters simply this? Douglas wrote and called your attention to the Renegotiation Act.

Mr. Friedman: Yes.

The Court: And they said that they wanted an agreement [17] from your company to the effect that they would comply with it.

Mr. Friedman: Yes.

The Court: And that is what you did. Now haven't you, by reason of that contract, placed yourself in a position where you cannot raise the question of constitutionality?

Mr. Friedman: No, for this reason; that those letters only apply to contracts made with the Douglas people and which are in excess of \$100,000.00, any contract that is in excess of \$100,000.00. We are suing the Douglas people for work done in 1944. The renegotiation period covered by the unilateral order was the fiscal year ending 1942. There is nothing to show that the renegotiation was based solely upon contracts made with the Douglas people or with any contracts made with the Douglas people.

The Court: I know, but you are claiming, of course, that because there is no relationship between you and the government that you are not subject to this Renegotiation Act.

Mr. Friedman: That is true.

The Court: But haven't you, by your agreement with Douglas, agreed to be bound by it?

Mr. Friedman: No.

The Court: What do your letters mean?

Mr. Friedman: Our letters mean just what they say. I am assuming now that we are bound by an unconstitutional [18] Act, according to your Honor's statement. The only thing that those letters did was for the Douglas people to agree that orders placed by Douglas with Manlove and Spaulding should be subject to renegotiation; that is all that letter says.

The Court: Well, what do you say?

"We hereby agree that special conditions 42 and 42-A printed on the reverse side hereof shall be applicable to all purchase orders which you issue to us under Army and Navy contracts, respectively, provided, however, that this agreement shall cover only purchase orders in which you are required by law or by contract to insert such special conditions and shall continue only so long as such requirement may be effective."

Then it sets forth the conditions, and follows out the Renegotiation Act as originally adopted.

Mr. Friedman: True, but it is limited to the orders placed by Douglas.

The Court: I know, but you agreed——

Mr. Friedman: In other words, we don't agree with Douglas that any business we have done with anybody else is subject to renegotiation; we have made no such agreement by these letters. We simply agreed with Douglas, according to their own letter, that the orders they have placed with them

should be subject to renegotiation, in the event that [19] any one of those orders exceeds \$100,000.00. Now that is all the letter says. Now along comes the government in 1944 and says, "We find that from all the business that you have done in the fiscal year of 1942 you have earned excessive profits." There is nothing to show that we earned any excessive profits only on contracts of Douglas, and there is nothing to show that we agreed to be bound by a renegotiation that involves business done with other firms. And even our letter of acquiescence says:

"We agree to special conditions 42 and 42-A" and so forth, "shall be applicable to all purchase orders which you issue to us under Army and Navy contracts, respectively, provided, however, that this agreement shall cover only purchase orders in which you are required by law or by contract to insert such special conditions and shall continue only so long as such requirement may be effective."

The Court: Then what do you say to this, for instance, on the exhibit attached?

"Seller agrees that buyer shall not be liable to seller for or on account of any amount due to the government by seller or deducted by buyer from payments otherwise due under this contract pursuant to directions from the Secretary in accordance with the provisions of this article."

Mr. Friedman: That is true, but that likewise is [20] limited by the——

The Court: But then haven't you estopped yourself from asserting the claim against the Douglas by reason of this?

Mr. Friedman: No.

The Court: They have relied upon your agreement here and you have accepted orders on the strength of it and continued to do business with them. Hasn't that, in effect, estopped you from asserting that any money that they are withholding on account of the orders of the Secretary——

Mr. Friedman: Let me go back and read to you the beginning of special condition No 42-A

“At any time when, in the judgment of the Secretary, the profits accruing to seller under this purchase order can be determined with reasonable certainty, the Secretary and Seller, upon the written demand of the Secretary, will renegotiate the price with a view to eliminating such profits as are found, as a result of such renegotiation, to be excessive.”

What profits? The profits under that particular order. There is no consent here to a renegotiation of their entire business for a year.

“In the event that such renegotiation results in a reduction of the price,——”

The price of what? The price under that order.

“——the amount of such reduction shall, as may be [21] directed by the Secretary, be deducted by the buyer from payments to seller under this purchase order.”

And then follows subdivision C, which relates to the very same thing. In other words, if any one of these particular contracts are renegotiated and the price is found to be excessive all that the plaintiff has agreed is as to that particular order we will abide by such renegotiation. But we haven't that situation here.

The Court: Let me ask you this. Is it true that all orders that they received after this Renegotiation Act had similar provisions? All your prime contractors.

Mr. Friedman: No, I don't believe that is true.

Mr. McMullen: Practically none of them have it, sir. Here is an example right here in 42. Here is where they set the orders, right here. It shows what general paragraphs apply. 42 and 42A are in none of them except the original. These are the orders involved in this suit. We have the complete set here. Your Honor might look at them.

The Court: Proceed.

Mr. Friedman: As I say, even adopting your Honor's view of it, we are only bound as to renegotiation for any particular order that is placed by Douglas with plaintiff. But we have not that situation here. We have here a unilateral order which says that considering everything in the year 1942 the Secretary determines that the profits that you [22] made are excessive in the amount of so much. That excess may have come from order from a firm entirely different than the Douglas people. These letters, and even the conditions annexed and set forth and which they agree to are not broad enough

to say that because you are giving us some orders which you, in turn, have to supply to the government, we agree that all our business shall be renegotiated. There is no such provision there.

The Court: Well, isn't the law itself a part of every contract or purchase order that was issued after that date?

Mr. Friedman: Only a valid law.

The Court: That is true.

Mr. Friedman: Only a valid law, and only to this extent. We concede, as we perforce have to concede, that Congress can by a general law say that all contracts made by the government, whether it expresses itself or not, shall have this provision, and it has been held that by that Act those things are incorporated in all contracts of the government. But we have not a government contract here. We are not contracting with the government in any way. We have simple contracts between private citizens, private individuals and, therefore, the provision that it shall be, by reference, incorporated without specification in any contracts of the government does not apply to us. And, as I said before, only a valid law. So on neither one of these theories are we estopped from seeking an ultimate judgment of this court [23] on the merits, on the ultimate question involved in this suit.

The Court: Under the statement that has been made here it is more or less definitely agreed that the Douglas people were paid by the Federal Government and Douglas, in turn, paid their subcontractors.

Mr. Friedman: True.

The Court: What have you to say to the proposition that it is beyond the functions of the court to interfere with Congress in the disbursement of its funds?

Mr. Friedman: I have to say: that while the court cannot interfere with the disbursement of funds of Congress, the court can determine whether or not—let me put it this way. While the court cannot pass upon the wisdom that prompted Congress to disburse its funds, the court can pass upon whether Congress had the power to disburse its funds, because that is the very purpose of the courts.

The Court: Well, do you base your answer on that premise?

Mr. Friedman: No, I am only answering the question as your Honor propounded it. But if I construe your Honor's question correctly, it is this. We are not involved here with the disbursement of government funds by Congress. That would only arise in a controversy between Douglas and the government. We are not paid by the government. It is true that Douglas is paid by the government, but we are not paid [24] by the government. We are paid by Douglas. I have cited, as your Honor recalls, in the brief a case which I think answers your Honor rather clearly, where the government had employed a prime contractor in which they agreed to pay for the expenditures for labor of that contractor, plus 15 per cent. The laborer sued the gov-

ernment in the Court of Claims, on the ground that——

The Court: Yes. You need not repeat that.

Mr. Friedman: Your Honor is familiar with that.

The Court: I am familiar with it. But the point that I am making is this: that the Supreme Court of the United States has held that it is the sole function of Congress to expend the funds of the government, through the Executive, and that when there is an attempt to interfere with the disbursement of funds under an appropriation—and this, of course, is a part of the Appropriation Act because it is a guide for the Appropriation Act; in fact I think it was a part of the Appropriation Act, was it not?—that then that is a matter that is solely with the Executive and does not become a function of the courts.

I assume you are familiar with the case of *Perkins v. Lukens Steel Co.*, 310 U.S. at 113, where they had the Public Contracts Act up, and in that situation the Secretary of Labor was to fix the minimum of wages to be paid on public works, and the Court of Appeals of the District of Columbia enjoined the steel companies, and Mr. Justice Black, in a very [25] scorching opinion of the court, held that the courts had no jurisdiction. I will see if I can find the parts that I have in mind. And I am interested to find out how we can circumvent this case. I will read a number of parts. I will read the first part. It gives a little bit of the picture.

“In exercise of its authority to determine conditions under which purchases of government supplies shall be made, Congress passed the Public Contracts Act of June 30, 1936. By virtue of that Act, sellers must agree to pay employees engaged in producing goods so purchased ‘not less than the minimum wages as determined by the Secretary of Labor to be the prevailing minimum wages for persons employed on similar work or in the particular or similar industries or groups of industries currently operating in the locality in which . . . the supplies . . . are to be manufactured or furnished under such contract.’ The Court of Appeals for the District of Columbia has held that the Secretary erroneously construed the term ‘locality’ to include a larger geographical area than the Act contemplates, and has ordered six Members of the Cabinet including the Secretary of Labor, the Director of Procurement and all other officials responsible for purchases necessary in the operation of the Federal Government, not to abide by or give [26] effect to the wage determination made by the Secretary for the iron and steel industry either as to the complaining companies or any others.”

Then it goes on and tells of the steps whereby the reviewing court passed upon that and enjoined for more than a year the enforcement of that Act, and we find this language:

“Like private individuals and businesses, the Government enjoys the unrestricted power to produce its own supplies, to determine those with whom it will deal, and to fix the terms and condi-

tions upon which it will make needed purchases acting through its agents as it must of necessity, the Government may for the purpose of keeping its own house in order lay down guideposts by which its agents are to proceed in the procurement of supplies, and which create duties to the Government alone. It has done so in the Public Contracts Act.”

Further on it says:

“Courts have never reviewed or supervised the administration of such an executive responsibility even where executive duties ‘require an interpretation of the law.’ Judicial restraint of those who administer the Government’s purchasing would constitute a break with settled judicial practice and a departure into fields hitherto wisely and [27] happily apportioned by the genius of our polity to the administration of another branch of Government.”

“We find nothing in the Act indicating any intention to abandon a principle acted upon since the Nation’s founding under which the legislative and executive departments have exercised complete and final authority to enter into contracts for Government purchases. The Committee Hearings and Reports and the construction of the measure by its sponsors disclose no purpose to invoke judicial supervision over agents chosen by Congress to perform these duties. And sections 4 and 5 do not subject a wage determination to such review. Provision for hearings and findings by the Secretary with respect to decisions upon breaches of stipulations by contractors, once purchases have been

made, is indicative of a lack of intention to create any rights for prospective bidders before a purchase is concluded."

"In this legislation Congress did no more than instruct its agents who were selected and granted final authority to fix the terms and conditions under which the Government will permit goods to be sold to it. The Secretary of Labor is under a duty to observe those instructions just as a [28] purchasing agent of a private corporation must observe those of his principal. In both instances prospective bidders for contracts derive no enforceable rights against the agent for an erroneous interpretation of the principal's authorization. For erroneous construction of his instructions, given for the sole benefit of the principal, the agent is responsible to his principal alone because his misconstruction violates no duty he owes to any but his principal. The Secretary's responsibility is to superior executive and legislative authority. Respondents have no standing in court to enforce that responsibility or to represent the public's interest in the Secretary's compliance with the Act. That respondents sought to vindicate such a public right or interest is made apparent both by their prayer that the determination be suspended as to the entire steel industry and by the extent of the injunction granted."

"The case before us makes it fitting to remember that 'The interference of the Courts with the performance of the ordinary duties of the executive departments of the Government, would be productive of nothing but mischief; and we are quite satisfied

that such a power was never intended to be given to them'." [29]

"Our decision that the complaining companies lack standing to sue does not rest upon a mere formality. We rest it upon reasons deeply rooted in the constitutional divisions of authority in our system of Government and the impropriety of judicial interpretations of law at the instance of those who show no more than a mere possible injury to the public. The judgment of the Court of Appeals is reversed, and that of the District Court dismissing the bill is affirmed."

Now, they are as much as saying in there that it presents no justiciable controversy when it comes to the expenditure of public funds.

Mr. Friedman: No. Well, I don't want to dispute your Honor, but isn't this what the case holds, in substance; that where a principal empowers an agent to make contracts and, merely for the guidance of the agent, sets forth certain things which it says the agent shall be guided by, that if the agent disregards those instructions and enters into a contract with a third person, the third person, who has voluntarily entered into such a contract, cannot complain that the agent has stepped beyond the bounds of his instructions as that is a matter that is solely between the agent and his principal?

The Court: No, that isn't what it holds, in my mind.

Mr. Friedman: That is just what Justice Black says. [30] But, furthermore, conceding that when

it comes time for Congress, directly by legislation or through agents, to make contracts and enter into the expenditure of public funds, if it is a subject-matter that Congress had a right to act upon, the courts will not interfere with the wisdom or with the manner of that expenditure.

The Court: Well, the Congress, under the Constitution, has the sole power——

Mr. Friedman: ——to expend money.

The Court: ——to expend money. That also gives it the right to state under what conditions it will be expended.

Mr. Friedman: That is true.

The Court: And that is the power of Congress and not the function of the courts to interfere with.

Mr. Friedman: That is true, I will concede that, in the event that Congress acts, first, in a constitutional manner and, secondly, pursuant to a power it has under the Constitution. The power of Congress to make the appropriations, the expenditures of public money is limited to constitutional purposes.

The Court: I know, but——

Mr. Friedman: All right.

The Court: Just a minute on that statement.

Mr. Friedman: Let us concede that.

The Court: Just a moment on that statement. What is a constitutional purpose for expending money? The grant [31] given to Congress under the Constitution is pretty broad.

Mr. Friedman: It has the right to spend money

in pursuance of any of the 18 powers conferred on it.

The Court: I know, but in your brief you recognize that the purpose of this Act is salutary.

Mr. Friedman: I simply concede, for purposes of argument, that it is salutary.

The Court: Well, let us go a little step further so that there will be no misunderstanding. This court takes the position, and there is nothing that you can say to the contrary that will change my view on that, that it is not only salutary that Congress control the so-called war millionaires that developed out of the last war, but absolutely essential, and the very system that you are fighting for, the profit system, you are threatening—I am not saying you——

Mr. Friedman: I know what you mean.

The Court: ——but I say take this particular case. But claiming that Congress cannot control these excessive profits is to say simply the death knell of your profit system, because when this war is over and all this new crop of millionaires springs up, if they do spring up as a result of the profits of the war, when these boys get home look out for your profit system. The facts as set forth in the affidavits of these large concerns that have returned voluntarily their excessive profits indicate that they must be [32] fair if they are going to protect the very system upon which they exist.

Mr. Friedman: I agree with that.

The Court: So let us not argue that point.

Mr. Friedman: No, I am not arguing that, your Honor.

The Court: I just want that to be clear.

Mr. Friedman: I think your Honor overlooks one fact, and probably we are getting a little beyond the confines of this case. While we talk about these excessive profits the court must not overlook the fact that many of these profits, the greater percentage of all these so-called excessive profits have been recaptured by the government by way of income taxes.

The Court: I know, but that is taken into consideration in your renegotiation.

Mr. Friedman: No, no. Oh, no, your Honor. The Act provides that they have nothing to do with the tax problem except when they determine that there is excessive profits then there shall be certain bookkeeping entries made in the Treasury Department to show that instead of income tax that comes to the government as a recapture. In determining whether the contract is excessive or not they do not take into consideration what has to be paid for income taxes.

The Court: I know, but in renegotiation, the final settlement, the two are adjusted.

Mr. Friedman: Well, that is really a bookkeeping entry. [33]

The Court: It is simply, you might say, a method to circumvent any excessive profits; if they don't get it by taxes they get it by recapture.

Mr. Friedman: But in all of these cases, as-

suming that everybody has paid their taxes—they should—the government has already got about 70 per cent of the money that is excessive before they ever get around to redetermination. But let me come back to this matter that your Honor is discussing. Granting now that the government has the right to expend its money, granting that it has the right to put whatever terms and conditions it wants into its contracts, granting that it has the right to see that those terms and conditions are strictly conformed to by the other contracting party, we have not that situation here because we have not contracted with the government.

The Court: Now let us find out about that. Not a direct contract, but I think we can assume, at least for the sake of argument, that this Act applied to Douglas.

Mr. Friedman: Yes, I don't think there is any question of it, if it is valid.

The Court: And it was part of their contract, so they were subject to renegotiation. You took a contract to furnish certain parts or plans and specifications, and in light of these letters weren't you bound to their portion of the contract by reason of these letters?

Mr. Friedman: No. [34]

The Court: They were not in direct privity, but aren't you in a position of anybody that acts as a subcontractor, that he has to perform certain portions of the prime contract? And these letters are part of it?

Mr. Friedman: Well, let me divide that into

two parts. First, if there were no letters it is very clear that we, as subcontractors, could not have proceeded against the United States for any part of our subcontract. It is likewise clear that the United States could not have proceeded against the subcontractors; its sole remedy was to look to its prime contractor, and if the prime contractor came along and said, "I am sorry but I subcontracted so-and-so," the government would have a perfect right to say, "We are not concerned with what your dealings with subcontractors were, our dealings were with you and you have agreed to do this and this and this." Now, have these letters altered that situation in any way? Before the government could claim any rights under these letters it would have to show that the contract price of Douglas was excessive, or it would have to show that certain portions of the work done by plaintiffs for Douglas was based upon an excessive price, if there is any such thing.

The Court: Well, I know that some people do not believe there is such a thing as excessive profits, but I happen to be one of those that does believe it.

Mr. Friedman: There is in our common understanding, but [35] just what each person thinks is excessive may differ. But is this not the point? Let me put it this way. Can the government come in and say, "Now, Mr. Douglas, we had a contract with you in which you agreed to turn out so many airplanes at so much money. You had a subcontract. Now, that subcontractor, although it has not made any excessive profits off of the subcontract

with you, has, in dealings with a half dozen other firms, made a million dollars too much profit. Therefore, under our contracts with you, and the agreement of this subcontractor that if its profits with you are excessive," which is not the case here, "but because it has had that contract with you we are now going to say that this man, this firm, this subcontractor is subject to an invalid law, and we are going to renegotiate everything he has done, and you are going to hold the money out and pay it to us." Now, that is just the situation we have here. This is not a case where the government has come along and said, "Pursuant to these letters we find that the contracts that you had with Douglas have produced an excessive profit." They do not say any such thing. What they say is, "We find that due to all the work you have done in 1942 you made an excessive profit." So we find our subcontractors in a far different position than prime contractors. Prime contractors, no matter if they dealt with the army today and the navy tomorrow and the marines the next day and some other department of the government the next day, the government could come in [36] and say, "Here, we can renegotiate all your business even though in dealing with this particular branch of the armed forces you never made a penny profit, but in dealing with this branch over here you made a great deal, because, as a prime contractor, this law, if it is valid, gives us the right to renegotiate everything you have done, or if it is invalid, because, by your

agreement with us, you have agreed to be renegotiated on all your work with the government.”

But when you step down one notch to the subcontractor and find that the subcontractor has only by agreement provided that he will be bound by the renegotiation, solely and exclusively as to certain and particular orders, then it is only those orders that they can base a valid redetermination upon it, in fact, the Act is invalid. Now, that is our position here and that is what we are contending for; that these letters do not give the government a blanket power to renegotiate under an invalid statute, and if they have any effect at all they limit the government—just as the government must limit other people, the government is, in turn, limited—they limit the government to the right and power only to renegotiate those contracts that the plaintiff has with Douglas, and nothing else.

Now, the answers show we weren't only doing business with Douglas, we were doing business with many firms in 1942, never once directly with the government. Now, that being so, there is no showing that these contracts were the ones [37] that were renegotiated, or that there was a penny of profit made, let alone excessive profit, under the Douglas contracts. Then when the government says, “We can't pay you any money,” we have a right to come in and say, “Why, you have got to pay us the money unless we are bound by the Renegotiation Act, and if the Renegotiation Act is invalid you have no defense to the paying of this

money because you owe it to us.” So I think that puts us right back where we started.

The Court: I am ready to listen to any argument either side wishes to present, except that I do not wish to have the same ground covered that is covered by these affidavits.

Mr. Friedman: There is one more ground I want to call your Honor’s attention to, and I would like to call your Honor’s attention to that because it has been raised in the reply brief of counsel. Counsel raises this point, or, rather, the government raises this point; that we have no standing before this court because we have not exhausted certain administrative remedies. I don’t know whether your Honor has given any thought to that at all, I mean beyond what is said in the brief. However, the argument of the government in that regard, I think, has been settled by the Supreme Court last January in the case of *Coffman v. Breeze Corporations*.

The Court: You cite that in your memorandum?

Mr. Friedman: I give it in my closing memorandum. In that case plaintiff brought a proceeding in equity to enjoin [38] the defendants from paying certain royalty payments to the government. It had to do with the Patent Royalty Payment Act, in which Congress enacted a law that if any patents were involved in the war effort, or whatever it was, and the royalty agreements were too high, that Congress or some designated official could determine what the proper amount of royal-

ties, that is, non-excessive royalties, should be paid, and had the power to issue withholding orders to the licensees under the patents not to pay the royalties. The court held that there was no justiciable issue before the court because, it being a proceeding for an injunction, the plaintiff had an adequate remedy at law in that he could sue the licensees for the royalties, and that in that suit, it being set up that the payment was refused to be made because of the withholding order made under the Royalty Adjustment Act, that in that suit the constitutionality of the Act would be the paramount issue and the court would have to determine it under that Act. Now, that comes pretty close, your Honor, to what we have here and to what we have already discussed. The government has the right to control its expenditure of funds. It passed a bill providing that if the government was using these patented articles and devices, that when it came down to paying for it, it could readjust the royalties that some third person was to get, just like a subcontractor is to be paid, and the court held in that case that in a suit brought for the recovery of the [39] royalties, even though the government had stepped in and made a determination, that the owner of the patent couldn't receive all the royalties that he had set forth in his license agreements; nevertheless that in that suit the validity of the Royalty Adjustment Act would be the direct point in issue, and the court said—it is only a very few words:

“Compliance with the duty under the Act to pay into the Treasury the royalties withheld from appellant would operate, by the terms of the Act, as a discharge of the obligation to pay appellant.”

That is under the withholding order.

“If that defense were offered the constitutional validity of these provisions of the Act would be a justiciable issue in the case, since upon its adjudication would depend appellant’s right of recovery.”

And that is just exactly what we have here, whether you call it the Royalty Adjustment Act, whereby the government has the right to readjust royalties contained in private contracts, or whether you call it renegotiation, whereby they have the right to adjust payments to be made in private contracts. There is no difference. In each instance the government makes a determination and in each instance the government issues a withholding order, and in each instance the Supreme Court says when the suit is brought by the person who claims it is entitled to the money under the contracts, [40] the court must pass on the constitutionality of the Act. That was decided last January by the Supreme Court.

That is the only other point outside of those in the brief.

The Court: Let me ask this. This Act has been constantly amended where experience has indicated it needed strengthening. Under the original

Act there was no provision for a review by the Tax Court, was there?

Mr. Friedman: No, no provision until the Revenue Act of 1943 was adopted in February of 1944.

The Court: Not until 1944?

Mr. Friedman: That is right.

The Court: Would not this picture have to be viewed through the law as it existed in 1942?

Mr. Friedman: That is true, and so I have set up in our brief, and I have emphasized that fact, with this exception; it would have to be viewed, I take it, as the law existed at the time the unilateral order was made, which was subsequent to 1942, because the amendments from 1942 to 1944 didn't change the basic structure of the business at all. It added to it by providing that certain other departments of the government were involved, and so forth. You see, all the Act says, and I am not going to reargue that point, all the original Act said was if anybody has made excessive profits the government has a right to determine those and recapture them. Now, summed up, that is what [41] the original Act said, and that portion of it was never changed until the Revenue Act of 1943 was adopted in February, I think it was, February of 1944, and, by the very terms of that Act, it is not made applicable to any fiscal year that ended before January 30, 1943; so that, this being a fiscal year of 1942, as your Honor says, the whole matter has to be determined under the terms of the original Act.

The Court: There is one part of this picture that hasn't been quite clear to me, and that is that provision, "be recaptured within a year."

Mr. Friedman: I haven't really given much thought to that. Whether that means that the proceedings for its recapture have to be commenced within the year, which the Revenue Act of 1943 now says, that the proceedings must be commenced, renegotiation proceedings, within the year, or whether it means that the actual ultimate determination under the old Act had to be made within a year I don't know.

The Court: It seemed to indicate to me that a man is to know within a year's time where he stood.

Mr. Friedman: It seems to me that that would be the logical construction to place upon it; because to say that a man can go ahead and conduct his business and, assuming that he has made excessive profits, pay his income tax and dispose of it in some other manner, and along comes the government a couple of years afterwards, in this case two years afterwards and says to this man, "Two years ago [42] you made a lot of money you have got to give back."

The man says, "I haven't got it any more."

"Well, that is just too bad. We will just take everything you have got. That's all."

Frankly, I haven't mentioned it in my brief, but I haven't passed upon it and I am not in a position to give more than my own personal opinion. I mean I have no authorities to support that phase

of it. I didn't think it would be brought up. But there is another point.

The Court: Wouldn't that be a question that this court would more or less have to pass upon? If the renegotiation was too late then there is no controversy?

Mr. Friedman: Yes, that is true. If the renegotiation was too late then the Secretaries were without jurisdiction to make the order, and if they were without jurisdiction to make the order—and I use it in the broad sense, not as applied to the court—they were without the power and authority to make the order. In other words, if this operates as a statute of limitations upon their activity, then the order is void on its face.

The Court: Is there any more you wish to say?

Mr. Friedman: That is all I wanted to call your Honor's attention to, except to this very ambiguous part of the Act of 1942. We have in our briefs and I have done it a great deal in discussing this matter with the court, referred to renegotiation, but, as I read the Act of 1942, renegotiation in the Act of 1942 contemplates a voluntary agreement between the Secretary and the contractor. I see nothing in the Act of 1942 that allows a unilateral, ex parte, determination. It says: "When, in the opinion of the Secretary, a contractor has received excessive profits, he shall renegotiate the contract as follows," and then it provides for conferences and agreements at which the figure is mutually agreed upon. I see nothing in the Act——

The Court: Well, then, an obstreperous contractor could destroy the effectiveness of the Act.

Mr. Friedman: I realize that is a weakness, because I realize that no person by refusing to take part in a matter can say that nobody else has a right to do it and I merely mention that as an indefinite part of the Act. I do not think it is a valid objection, I will be perfectly frank about that, but it certainly leaves the Act in a very nebulous condition, other than the fact that no man, having been served with process, merely by staying away from court can prevent somebody from getting a judgment. There may be such a thing as a default under these proceedings, too. The new Act corrects it. The Revenue Act of 1943 expressly provides, even if they appear or don't appear, if they don't agree, that the Board of its delegated authority can make a unilateral determination.

Your Honor has referred to the fact of the Tax Court. Of course, I assume your Honor is not confusing the word "court" with "court" in its ordinary sense.

The Court: No.

Mr. Friedman: The Tax Court is only an administrative agency. It is not a judicial body.

The Court: I understand that.

Mr. Friedman: I just wanted to be sure. Sometimes the mere use of the word "court" leads us to believe it is a judicial tribunal.

I have nothing further except what is in the brief, your Honor.

The Court: We will take a five-minute recess at this time, gentlemen.

(Short recess.)

Mr. Lowry: Your Honor, I would like to make one or two suggestions in connection with the points raised by your Honor in this morning's discussion. First of all, with respect to these letters that are included in the answer of Douglas, Mr. Friedman has suggested——

The Court: Will you speak a little louder, please?

Mr. Lowry: Mr. Friedman has suggested that those letters are not applicable here because they relate only to Douglas' business, and he has implied, as I understand him, that that renegotiation did not reach the Douglas' business. The order of the Undersecretary which appears in the complaint determining excessive profits concludes by saying that \$110,000.00 profits realized by the contractor during its fiscal year ended December 31, 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act are excessive. Now, it seems to me that that order plainly points out that the order reached all of the contracts which were subject to the statute and, accordingly, the order reached these contracts with Douglas, the contracts between Manlove and Douglas, the purchase order agreements and, accordingly, it seems to me that Mr. Friedman is in a position where he is attacking an order that is founded at least in part on a renegotiation proceeding to which he has already agreed.

Your Honor mentioned this morning also the case of Perkins versus Lukens Steel.

The Court: Before you leave the other point I would like to know if that is all you have to say on the question of whether the parties are bound by their contracts, and, secondly, whether or not, by reason of those letters, which I feel form a contract, they are not estopped from now asserting the unconstitutionality of the Act because they were not only doing business with them at the time but continued to do business with them after the execution of those letters. I would like to get your viewpoint on these two angles.

Mr. Lowry: We have suggested in the brief, your Honor, that this plaintiff is not in a position to contest the constitutionality of this statute because he continued to do [46] business after the Renegotiation Act was placed on the books, and we think that what the Lukens case stands for is the proposition that because the government states the terms upon which it will do business, then your remedy if you do not like those terms is not to go into court and complain about it, your remedy is to do business with someone besides the government; and we have always felt that at least as to business transacted after April 28, 1942, when this statute went on the books, you can make a very strong argument that anyone that continued to do business which, under the terms of the statute, was subject to the Act, has, by doing that business, consented to the application of the statute, consented to renegotiation in accordance with the terms of the Act; and, as your Honor

indicated, I think the Lukens case stands for that proposition and supports that argument. Our difficulty, your Honor, with the Lukens case, and why we have not considered that it is a complete answer to renegotiation problems arises with the business, with the contracts entered into before April 28, 1942. As your Honor knows, the statute applies not only to contracts entered into after the date of the Act, but it applies to contracts which were entered into prior to the date of the Act, but as to which on the date of the statute final payment had not been made. Now, we have had some difficulty in getting to the conclusion that as to that part of the business you cannot fairly say to the contractor—— [47]

The Court: Well, doesn't that represent a difficulty in this whole picture because of a split? At one time, business up until April 28, 1942, there was no provision for renegotiation, and then after that it was subject to renegotiation.

Mr. Lowry: That is right, your Honor.

The Court: One of the problems that has concerned me is the apparent retroactive effect of this Renegotiation Act.

Mr. Lowry: That is certainly a point for consideration. The facts which necessitated that the statute be made retroactive, if we may use that term, are explained in the affidavit of the Undersecretary of War. Your Honor will recall that although this Act was entered into only four months after we got into the war, by that time so rapid had been the rate of contracting between the government——

The Court: I realize the reason, but it is strictly

a legal proposition for the court to consider. Now, here is a man doing business and at least is supposed to know the conditions under which he is doing business and we find that there is a law that affects business prior to April 28th; also that they renegotiate any profits that he made on business before that date, practically four months, one-third of the year.

Mr. Lowry: That is so, your Honor, and we feel, as I say, that there is difficulty in applying the rule of the *Lukens Steel* case to that business. We do not believe that [48] there is any substantial doubt about the constitutionality of what the Congress did, because it is certainly said, by a host of cases, that Congress may regulate existing contracts and may regulate the profits from existing contracts; that is, two people, by getting into contractual relationships with each other, cannot release their business from the power of Congress to regulate it; and we have cited the power of Congress to regulate it; and we have cited in our reply brief any number of decisions to that effect, including the *Norman* case and the *Blaisdell* case and a great many others. So that, while we feel it may be as to that business your Honor may wish to consider the constitutionality of the statute on the merits we do not believe there is any doubt about the constitutionality as so applied.

The Court: Now, both parties present this case on the sole question of the constitutionality of the Act. In other words, is the Act constitutional or is it unconstitutional? Now, when we look at the Act

in that manner we are not concerned with the first four months, we are concerned with the statute. Now, the position of counsel for the plaintiffs is that if the Act is held constitutional they have no cause of action; and you would admit that if it is unconstitutional that you have no defense.

Mr. Lowry: We have thought that was so, your Honor, because this statute does——

The Court: Well, that is the position you are taking. In other words, you are trying to put this thing right up to [49] the court for final determination to find out where you stand.

Mr. Lowry: That is so.

The Court: Now, I might ask counsel for plaintiff: Do you contend the Act in its present form is unconstitutional also?

Mr. Friedman: You mean as it now exists?

The Court: Yes.

Mr. Friedman: Yes, your Honor.

The Court: In other words, you claim the whole picture presents an unconstitutional method—not a method—but on account of the indefiniteness of the term “excessive,” that makes the Act unconstitutional?

Mr. Friedman: In other words, we assume, for the purpose of all these proceedings, that Congress does have the power to provide for renegotiation, but we contend that it has not exercised that power in the manner prescribed by the Constitution. Boiled down, that is our position.

Mr. Lowry: Well, your Honor——

The Court: Pardon me for the interruption.

Mr. Lowry: Surely. What I was trying to say is that we think that the Lukens case probably forecloses all argument about the constitutionality of the Renegotiation Act in so far as the renegotiation applies to business done after the statute came on the books. We think that is simply an expression of the familiar rule that the statutes [50] in effect at a given time become part of each contract executed by private parties.

The Court: But am I concerned about that first four months? Their cause of action or two causes of action—are there not two causes of action?

Mr. Lowry: I think so.

The Court: One cause of action is for declaratory relief and they ask for a declaratory judgment that this Act is unconstitutional, that is what they are asking for, and that, by reason of it being unconstitutional, the Douglas people owe them this amount that you have stipulated to this morning. Now, to use the slang expression, you have put it up, just cold turkey, to the court whether that Act at that time, when it was adopted by Congress, was constitutional. Now, whether it was retroactive or not, that is another question, isn't it? That is not in issue in his case.

Mr. Lowry: Well, possibly not. I think it may be because of the provisions of the order of the Undersecretary, which apparently on the face of the order reached not only the business done after April 28, 1942, but also the business done before that.

The Court: I know, but when it comes down to

the final analysis, aren't we concerned only incidentally with the orders of the Secretary? We are concerned with the statute here that is claimed to be unconstitutional.

Mr. Lowry: I see your point. You are suggesting that if this case is directed to obtaining a declaratory judgment that the Act as it came upon the books, regardless of its application, is unconstitutional——

The Court: Counsel in his brief said the sole question is the constitutionality of the Act.

Mr. Lowry: Well, if that is so, and I think possibly it is, then I would assume that you could at least make a very strong argument that you don't reach it because of the Lukens case, the case which says the government can state the terms upon which it will do business, and I assume that same rule would apply to business done indirectly through a private contractor. But I think your Honor will want to give consideration to the terms of this order in this connection. That is the only suggestion I have.

Mr. Friedman suggested that the tax returns in effect did the renegotiation job. That, of course, is not true. The figures your Honor will be interested in knowing in the hearings that were held not long ago in the House Ways and Means Committee——

The Court: Counsel, for some reason or other I can hardly hear you.

Mr. Lowry: I am very sorry. I say your Honor will be interested in knowing that in the hearings that were held not long ago before the House

posed to extend the statute again it was [52] pointed out that the total refunds under this statute now amount to about six billion dollars, and had the government relied solely on the Revenue Laws between one and a half and two billion dollars of that amount of money would not have been returned to the government; so it is perfectly plain on the figures, your Honor, that taxation is not an adequate substitute for renegotiation, as Mr. Friedman apparently suggested.

Mr. Friedman was referring to the government's position about exhaustion of administrative remedies. I think he has misunderstood what we argue. We do not contend that your Honor because of the rule of exhaustion of administrative remedies cannot consider the constitutionality of the Act. We do contend that the failure of the plaintiff to go to the Tax Court forecloses any consideration of the terms of the Undersecretary's order. If Mr. Friedman's plant was not satisfied with what the Undersecretary did, then his remedy was in the Tax Court, and our argument in the brief with respect to exhaustion of the administrative remedies only goes so far as to the amount and the terms of the order, your Honor, but it does not include any contention of the constitutionality of the statute.

Now, your Honor also suggested that it would be appropriate to consider this case on the basis of the law as it existed in 1942. I assume you are referring to the date of the order, February 2, 1944, which was issued pursuant to [53] the 1942 Act.

I think, your Honor, that the question for consideration here is not the state of the law at any particular time but the rights which the Congress by this statute gave to the plaintiff, and we think it doesn't make a bit of difference whether, in determining whether or not plaintiffs' constitutional rights have been violated, Congress passes one bill today and another bill tomorrow or passes both bills on the same day. The fact of the matter is that plaintiff did have a right under the Revenue Act of 1943, the amendments which became effective February 25, 1944, plaintiff did have a right expressly to go to the Tax Court, and we think that before this court or any court reaches the conclusion that renegotiation in some way denies due process, consideration must be given to the fact that Tax Court review was provided. It doesn't seem to us to make any difference whether Congress provided that review on April 28, 1942, or provided it on February 25, 1944, so long as the right was provided to the plaintiff.

The Court: Do I understand by your argument that Congress in 1944 could have passed this Act and made it retroactive as to the contracts of 1942?

Mr. Lowry: I am not suggesting that, your Honor. What I am suggesting is that when Congress, on February 25, 1944, specifically provided that people in the position of this plaintiff could go to the Tax Court, then it is appropriate for your Honor to consider the fact in determining whether [54] or not there has been any denial of due process of law to this plaintiff. If I may say it again,

it doesn't seem to me that if you are considering a man's constitutional rights, and whether or not Congress has denied them, it doesn't seem to me it makes any difference if Congress confers his rights upon him in two statutes instead of in one.

The Court: I know, but the Act of 1944 might have been constitutional and the Act of 1942 unconstitutional.

Mr. Lowry: That is conceivable, your Honor.

The Court: And the Act of 1944 would not make the Act of 1942 constitutional if it was unconstitutional, would it?

Mr. Lowry: Well, the question for decision here——

The Court: In other words, there might have been lack of due process under the original Act, but in 1944 due process was provided; in other words, to correct that defect that might have been ascertained in the original Act. Now, isn't that true?

Mr. Lowry: That is possible, your Honor, but what I am suggesting is that the question for decision in this court, as in any court in this country, is not an academic question as to whether or not some statute violates the Constitution. The question for decision always is: Has plaintiff been deprived of any of his rights under the law? And accordingly, in order to reach or in order to come to a conclusion on that question it is necessary to look at all [55] of his rights, not merely the rights provided in one statute but the totality of the rights that have been accorded to him. That is, it is in-

conceivable to me that a court could reach the conclusion that plaintiff's rights have been denied because he has no right to a hearing when the Congress specifically gave that man a right to a hearing, and I can't understand that it makes any difference whether Congress gives him that right in the first statute or the second statute. That is, I do not understand that the Constitution says to Congress, "Gentlemen of Congress, you have to do all your business on one day." I don't understand that.

The Court: They wouldn't do any business if that were true.

Mr. Lowry: That is right.

The Court: But that is not answering my question. At least, it doesn't seem to me it is answering the question. The question here would be whether the Act of 1942 provided for due process, would it not? For instance, there might be and have been, undoubtedly, cases where Acts have been held unconstitutional because of lack of due process.

Mr. Lowry: That is so, your Honor.

The Court: All right. Then can Congress come along and make an amendment that would be retroactive and make the original Act constitutional?

Mr. Lowry: Your Honor,— [56]

The Court: Isn't that what you are arguing?

Mr. Lowry: The difference between us is in the statement of the question. You state that the question for decision is whether or not the Act of 1942 was constitutional. I say that the question for de-

cision is the same as the question for decision in any court. The question is whether or not Congress has deprived this man of his constitutional rights. It is not an academic question about constitutionality of a statute. It is a question of what has happened to this plaintiff before this court at this time. There are a host of decisions——

The Court: I finally grasp your approach. Let me ask this. Doesn't the Act provide it shall be within one year?

Mr. Lowry: Your Honor, may I make one more suggestion about that other point? Even if we were wrong about what I have just suggested, nevertheless it is clear that there would be court review under the 1942 Act. The 1942 Act does not preclude court review, and there are decisions in the Supreme Court, including the case of *Stark v. Wickard*, which is cited in our briefs, which say that when the statute is silent the general jurisdiction of the equity courts of the United States applies and relief can be had if there has been arbitrary action. Furthermore, it was well understood under the original Act that there would be an opportunity for people to go to court, and that was necessarily so because your Honor will appreciate that what the Undersecretary [57] does is simply to make a determination of an amount—in this case \$110,000.00—but by signing the paper that doesn't get the United States' money. The United States has to get its money by one of the three methods provided in the statute.

The Court: I understand that.

Mr. Lowry: And each of those methods, your Honor,—pardon me.

The Court: That reminds me of another inquiry that I have. I was wondering why the plaintiff in this action could not have brought a straight action against Douglas for that amount of money, and that would have brought all the issues out.

Mr. Lowry: I think so, your Honor. I think that this complaint does both things——

The Court: Of course, the complaint is framed specifically to obtain a ruling on the constitutionality.

Mr. Lowry: That is so, and for a money judgment. It is for both things.

The Court: It is for a money judgment, but there will first have to be a decision of unconstitutionality as the initial step.

Mr. Lowry: I would assume so; otherwise the plaintiff is not entitled to relief. What I was about to say is that if the United States takes any one of those three methods for collecting its money the United States inevitably sets [58] up a law suit somewhere. That is, if the United States withholds the money which would otherwise be payable to the contractor, the contractor can come to the Court of Claims and sue the government on a direct contract. If the United States goes out and gets the money by bringing a suit in the District Court of the United States, as it may do under the statute, that, of course, sets up a judicial forum. And if the United States uses the other method of getting the money, the method employed here, why, then you

have the questions presented as they are presented here today. So that it seems to us very plain that there was adequate opportunity to go into the courts and adequate opportunity to get all the due process in the world under the 1942 Act, even if your Honor should construe that the 1943 Act is not applicable.

Now about this question of the statute of limitations, I assume that the provision which your Honor has in mind is Section 403 (c) (4), the very last sentence of Section 403 (c) (4), which reads:

“No renegotiation of the contract price pursuant to any provision therefor, or otherwise, shall be commenced by the Secretary more than one year after the close of the fiscal year of the contractor or subcontractor within which completion or termination of the contract or subcontract, as determined by the Secretary, occurs.” [59]

I read that to be simply a statute of limitations. I read that to mean, as it says, that you can't begin a renegotiation unless you do it within one year of the close of the fiscal year of the contractor within which the contract is terminated.

The Court: Are you reading from the original Act of 1942?

Mr. Lowry: Yes, your Honor.

The Court: What is it?

Mr. Lowry: It is 403 (c) (4).

The Court: (c) (4)? I don't find any (c).

Mr. Lowry: That must have come in in the amendment of October. It is on page 12.

The Court: Of your brief?

Mr. Lowry: Of the appendix to the brief.

The Court: Yes.

Mr. Lowry: You see, it is the first full paragraph.

The Court: There is nothing here to indicate when they commenced it.

Mr. Lowry: No, your Honor. That problem is not raised by these pleadings, and I assume that the reason is that it was commenced in time.

Mr. Friedman made some suggestion about the fact that there is nothing in the statute to indicate that renegotiation can take place unless it is done voluntarily. I think your Honor correctly pointed out that that could not have [60] been the intent of the Congress. The purpose of this Act was to avoid a situation in which you penalize the people that are co-operative, people that are not too anxious to get rich out of the war. The purpose of the Act was to make the voluntary procedure of renegotiation, which had been worked out by the community and the Services, applicable in all cases, whether people liked it or not, and I think it is generally understood that is the effect of the statute, and in that connection I might point out to your Honor that the language of the Act is that the Secretary is directed to eliminate excessive profits, and we think that makes it plain that the Congress intended that the statute should be mandatory.

Now, unless your Honor has some other problem in mind, I would like only to do this much about the constitutionality. I would simply like to refer to——

The Court: I might call counsel's attention to the fact that I asked for an advancement of this case until 9:30 this morning so that I could get away early, so if you are going to start out on a broad scope, why, I wouldn't want to break in.

Mr. Lowry: Unless your Honor has some reason or is anxious to hear some argument on the constitutionality I, at least, will be satisfied simply to refer to two statutes which are not in our brief and to which I think your Honor would like a reference. We have suggested in our brief that [61] this question of determining whether or not something is excessive is, in all substantial features, the same question that a public utility commission has in determining whether or not a rate is reasonable.

The Court: Of course, you, in your brief, have set up a number of examples where Congress has delegated to an agency certain authority or certain directions. And, of course, the plaintiff has been relying upon those mainstay cases of the Lever Act.

Mr. Lowry: Well, we have tried to suggest, your Honor, that the Lever Act cases are not applicable here because they don't involve the question for decision here; that is, the question of propriety of a delegation of power to administrative officials. So far as I know it has always been recognized that the Cohen Grocery case and companion cases are not guiding authorities in deciding the question that is presented here.

What I was about to say, your Honor, is that in connection with our contention that the job here is

no more difficult, that the standards are no more lucid than the standards which every public utilities commission applies, I would like to give your Honor a citation to the Transportation Act, as it is now known.

The Court: In addition to what you have already cited?

Mr. Lowry: Yes, your Honor. It is 49 U.S.C.A., Section 15. If your Honor will read that section you will see [62] that the Interstate Commerce Commission has the job of determining what is reasonable and what is fair, and there is no definition in the statute of "reasonable" and "fair." The words themselves are an adequate guide to action, the courts always hold.

The Court: We might ask this question, and it presents an additional reason why the court should avoid this constitutional question. What about the recent decision of Justice Douglas in the Squires case, wherein he states, in effect, that the decisions of the Supreme Court are to be considered with the Act to determine whether or not it is constitutional? Now, if that language is as broad as it imports on the face of it, the Supreme Court can clarify this by its own decisions.

Mr. Lowry: I am not sure that Mr. Justice Douglas is doing anything more than recognizing expressly what the court always does.

The Court: What the Supreme Court always does.

Mr. Lowry: That is right, what the Supreme Court always does.

The other statute, your Honor, is the Public Util-

ities Act of California. That is Act 6386, in Section 32.

The Court: What is it?

Mr. Lowry: It is the Public Utilities Act of California.

The Court: And your citation?

Mr. Lowry: It is Act 6386 in Deering's, I believe, [63] Section 32. If your Honor will note, there again you have typical language of "reasonable and unjust," and so on, without any further definition.

Mr. Friedman: May I say a word or two in reply? I will not be long.

The Court: I must leave in five minutes.

Mr. Friedman: I will only take four.

The Court: All right.

Mr. Friedman: First, your Honor, as to these tax cases and the tax statutes, we have cited and relied rather heavily upon the case of *Ryan v. Panama Refining Company*, which is quoted in our briefs. The court there discusses the tax statutes, or these rate statutes, I should say; and, as we pointed out in another place, the court is explicitly stating that under any of these statutes which give to commissions the power to fix rates, there is reserved to the Supreme Court the power of determining whether they have properly and correctly fixed a rate. We have no such situation here. Counsel has referred to our right to go to the Tax Court. All we could do in the Tax Court is to get a readjustment of the figure. We can't go to the Tax Court with the question of the validity of the or-

der. We cannot go to the Tax Court for the question of the constitutionality of the Act, because the Tax Court couldn't pass on it; it is merely an administrative agency and it must assume, under the law, that it must function according [64] to the Act.

Secondly, and lastly, if the Act is itself unconstitutional the provision that you can go to the Tax Court likewise falls with it, because what is the use of giving you an appeal to a court——

The Court: Counsel hasn't contended that you have the standing in this court—of course, he contends that as to the amount that was fixed, that by not proceeding you are bound by that amount, but he is not raising the question that you are not in court because you haven't exhausted your administrative remedy.

Mr. Friedman: I want to make it clear to the court; we are not contesting the amount in this case. We are contesting the whole order.

The Court: I understand that.

Mr. Friedman: Yes.

The Court: So that the court is not involved in so far as the order itself is concerned. It is only involved with the one problem. They are not claiming that you are not entitled to your day in court on the constitutionality of the Act. The only thing is that I am strongly of the opinion that it doesn't present a justiciable controversy for this court.

Mr. Friedman: I am not going into the balance of it. I am just coming back to this one point that Mr. Lowry made in his opening argument, I mean

in his remarks, and which I [65] think answers this thought that is in your Honor's mind. Assuming now that the representations I have made to the court find support in the record and that the order determining excessive profits was predicated upon all of the business done by plaintiffs, and leaving out the question of the division of that particular fiscal year under the statute, does not the argument presented merely come down to this: Because included in this order were some contracts that were subject to renegotiation by agreement or otherwise, that the order must be upheld? Is not the converse of that really the rule; that if that order is based upon the renegotiation of contracts that the government could not renegotiate, the fact that part of it is valid—a part that we can't divide here and determine the amount of—that fact renders the whole order void so far as this proceeding is concerned? In other words, you cannot say that because a fraction is good that, like a drop of bad oil that will spoil a quart of good oil, that that good part will purify the balance of the order? It can't be done. This order must stand or fall upon the ground that the Secretary constitutionally had the power to make it in its entirety. If it didn't, the order is no good.

The Court: Counsel, just a minute. I am very much interested in hearing anything and everything that counsel has to say, but I have a definite appointment. I opened court a half hour earlier this morning in order that I could [66] keep the appointment. I will be glad to, and not only glad but invite you to come back at 2:00 o'clock to pre-

sent anything additional that you may have to present, but I am now already late.

Mr. Friedman: I think we have fully discussed it. I just wanted to say this. That was the last point I wanted to call to your Honor's attention.

The Court: I don't want counsel to feel that you are shut off.

Mr. Friedman: No, I don't at all.

The Court: Because this is an important question. But I started in a half hour earlier so that I could leave.

Mr. Friedman: I understand that. You have been very patient and attentive with us.

The Court: The court has been very much interested in the whole subject matter and appreciates the able manner that counsel on both sides have presented the case. The only difference between counsel, it seems to me, is that we have about three sides to this case, two parties and the court. The court is trying and is still going to try to decide this case without passing upon the constitutionality; I feel that it is my duty, and I have spent considerable time on that angle of the case. While you gentlemen have tried to force me right into the corner, I have been trying to find a way to get out of that corner. I want to tell you frankly if I can decide this case to my own satisfaction [67] without passing on the constitutionality, I am going to do it.

Mr. Friedman: I think if your Honor will read *Coffman v. Breeze* you will find we have got you right smack in the corner.

The Court: I have had people think they had me in the corner before, but I wasn't in the corner when they got there.

Mr. Friedman: Well, I have seen that myself before.

The Court: And, after all, you know the court realizes that anything that I say on the question of constitutionality means little; that the real responsibility rests upon the reviewing court, and I am satisfied with the able counsel that are in this case that there is little that I could say on that question that would either help or hurt either one of you in presenting it to the reviewing court. So even if you think you have me in a corner and I get out of the corner, whether it is on sound grounds or not, you still have your full opportunity of presenting it on other grounds, on the ground that you are trying to have this case determined upon.

I am not fearful of the issue. I am simply mindful of the many admonitions that the books are full of relative to the duties of a trial court; in fact, the duty of the reviewing court also. But I am simply trying, in that respect, to perform my duty in accordance with the instructions [68] as given by the reviewing courts. It would be an easy matter for me simply to say "Motion granted" or "denied," and go on my way.

Mr. Friedman: Surely.

The Court: I realize that. And there would be no occasion for me to write any opinion on the subject matter, because it would soon be supplanted

by another opinion that might either affirm or reverse me, and then that would be only another step.

Mr. Friedman: Yes, there is always an easy way, your Honor, but it is not always the proper or best one.

The Court: So I have virtually convinced myself that I can get out of your corner.

Mr. Friedman: Well, I hope not.

The Court: Thank you, gentlemen.

Mr. Friedman: I want to thank you, Judge, for telling us what is in your mind. It is so unsatisfactory to argue to a court when you don't know what the court wants to hear, and it is so easy when the court tells you what it is interested in.

The Court: I am glad you think it was easy.

Mr. Lowry: Thank you, your Honor.

[Endorsed]: Filed Sept. 4, 1945. [69]

[Endorsed]: No. 11134. United States Circuit Court of Appeals for the Ninth Circuit. R. E. Spaulding, L. B. Manlove and P. M. Manlove, co-partners doing business under the firm name and style of Manlove & Spaulding Mfg. Co., Appellants vs. Douglas Aircraft Company, Inc., a corporation, and United States of America, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Filed September 4, 1945.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 11134

R. E. SPAULDING, L. B. MANLOVE and P. M.
MANLOVE, co-partners, etc.,

Appellants,

vs.

DOUGLAS AIRCRAFT COMPANY, INC.,
a corporation,

Appellee.

APPELLANTS' DESIGNATION OF PARTS
OF RECORD TO BE PRINTED AND
STATEMENT OF POINTS INTENDED TO
BE RELIED ON.

Appellants above named hereby designate for printing in the above matter the entire transcript, as certified by the Clerk of the United States District Court, including therein the reporter's transcript of the proceedings had before the United States District Court.

Appellants hereby adopt as their points on appeal "The Statement of Points on Which Appellants Intend To Rely On Appeal" as filed in said

District Court and as included in said typewritten transcript beginning with page 220 thereof.

Dated: September 6, 1945.

LEO R. FRIEDMAN

JOS. I. McMULLEN

Attorneys for Appellants

(Affidavit of Service by Mail attached.)

[Endorsed]: Filed Sept. 11, 1945. Paul P. O'Brien, Clerk.